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**OPTION CONTRACTS: A STUDY OF VARIABLE QUANTITY
CONTRACTS WHICH DO NOT OBLIGATE THE GOVERNMENT**

By

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John W. Hudkins
Vandenberg AFB, California
27 January 1983

INTRODUCTION

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A study of options in federal government contracts is a considerably different undertaking than a similar study of options in the common law context. Generally speaking, the common law concerns itself with the application of offer and acceptance principles with respect to options. Thus an examination of common law options usually focuses on their nature as a "continuing offer" and rules surrounding notice of acceptance.

But options in Government contracts are different. The rules governing ^{contracts,} ~~them,~~ contained in the various procurement regulations, both limit somewhat the occasions which they can be used as well as create technical requirements attending their exercise. The scope of a study of options in Government contracts is ~~then,~~ more complicated because of the regulatory overlay imposed.

This paper organizes the examination of Government contract options along the lines of Section 1, Part 15 of the Defense Acquisition Regulations. This is a logical approach, not only because it forces some review of the applicable regulatory provisions, but also because relevant case law seems to generally follow this pattern. ~~Thus~~ the chapters address the separate topics of applicability, evaluation, and exercise.

Chapter One, Applicability, treats the subject by looking at the purpose for including options in a particular contract. Distinguishing options to increase quantity from options to extend the period of performance, this chapter attempts to illustrate the applicability of options in comparison to other contractual means of accomplishing a particular purpose. Where the aim is to provide a contractual basis for increased quantities the applicability of options is viewed alongside of

indefinite quantity contracts and basic ordering agreements. Similarly where the contractual purpose is to assure the government the right to extend the performance period, the applicability of options is compared to multiyear contracts. Thus an understanding of the applicability of options in some part requires analysis of the purpose to be achieved by their use and the alternatives available.

Chapter Two, Evaluation, discusses what are perhaps the most elusive issues in the area of options. This area seems to breed litigation, perhaps in large part because not only must it be determined whether, indeed, to evaluate the optional portion of the bid, but also because evaluation itself is made difficult by the use of unbalanced bids. This chapter treats the major evaluation issue by first looking at responsiveness. This is done by addressing cases where options are evaluated followed by cases where options are not evaluated. The responsiveness rules differ depending upon whether or not the option is evaluated. The second focus of Chapter Two is on unbalanced bidding. This is a troublesome area, but one which can be analyzed. This section (Section C) is organized under the general heading of "Unbalanced Bidding", but that term as used in the subtitle is a generic term which includes unbalanced bidding as well as buying-in. The more precise use of unbalanced bidding occurs only where the option is evaluated. Buying-in occurs when the option is not evaluated. Nonetheless both are forms of "unbalanced bidding" and are so grouped herein. The chapter concludes with an examination of some efforts to ameliorate the practices of unbalanced bidding and buying-in.

The concluding chapter, Exercise, begins with a discussion of a commonly misunderstood topic, the requirement to "test the market" before

exercise. That is, to what degree is the CO obligated to determine that exercise of an option is in the Government's best interests. Following that is a section focusing upon the nature of the Government's right to exercise or not exercise an option. This includes discussion of a contractor's rights to compel the Government to exercise an option.

The rules respecting notice and timeliness of exercise are analyzed in the third section. The rules here are complicated by cases in which contracts are modified, but option exercise provisions remain unchanged. The concept of waiver of a defective exercise is also discussed in this section.

The final two sections treat exercise issues in unconventional contexts. Section D discusses "exercise" of the unpriced, or so-called "soft", option. It is difficult to formulate any rules here, but discussing the issues at least highlights the legal frailties of the concept of exercising unpriced options. Section E discusses "exercise" in issues pertaining to indefinite quantity contracts. Here, the Government's obligation to order a minimum quantity or quantities in excess of the minimum is reviewed. Although neither Sections D nor E are purely option exercise topics, they have a place within the general topic and are thus included.

Thus, the orientation I have sought to employ is that which a CO might be faced with during the procurement cycle. First, is an option indeed applicable to this particular procurement. Second, given that the Government wants options in the contract, how should they be evaluated to facilitate award. And lastly, now that the Government has the contractual rights embodied in the options, how can it perfect these rights through exercise.

CHAPTER I - Applicability

A. The Nature of Options in Government Contracts: An Historical Perspective

[A]n option is a unilateral right in a contract by which, for a specified time, the Government may elect to purchase additional quantities of the supplies or services called for by the contract, or may elect to extend the period of performance of the contract.

This rather straightforward language, found at DAR 1-1501, embodies not only the definition of options but also establishes the broad aspects of their applicability.¹ Two general uses thus emerge: options to increase quantity and options to extend the period of performance. These will be examined in detail separately, infra. But there are certain historical contexts which are of interest and which will first be addressed.

Options appear to have been used in Government contracts from an early time, although in a less formalized manner than today.

For example a pre-Civil War case involved a Navy contract which called for the furnishing of forty thousand pounds of butter to various installations. The contract further stated that Navy could require the furnishing of any additional quantities which it might need.² In response to the contractor's argument that the option clause bound the Navy to order additional butter from no other source, the Attorney General stated:

But I do not think that the clause of the contract referred to in your letter binds the Department to receive from Dr. Davis any additional quantity, which the exigencies of the service might demand, during the time for which the contract is to run. That clause was evidently inserted for the benefit of the Navy Department, and is in the nature of a consideration, moving from the vendor to the vendee. In

consideration of the advantages of the contract to Mr. Davis, he agreed that if the Department should, during the term of the contract, require an additional quantity of butter, he would furnish it at the same rate, thus securing for the Department against a rise in price, in case it needed an additional supply ...³ (emphasis added)

Similarly, a few years later the uses and characteristics of option contracts were again spelled out where a contractor sought to compel Government exercise:

The contract made with Harris and Beebe is for 100,000 pounds of a certain quality of tobacco, and the stipulation in the agreement simply gives the Subsistence Department the option to receive 150,000 pounds more of the same quality and at the same price upon giving due notice to the contracting parties prior to the date of November 30, 1878. So far as that portion of the contract is concerned, the option is entirely that of the Subsistence Department, and it must be presumed that it paid the price for that option in the price which it has given for the tobacco which it has contracted to purchase at all events, or in the benefit which the parties have otherwise derived from the contract.⁴ (emphasis added)

But another line of early cases viewed options in a different manner. In 1903, the Comptroller of the Treasury was asked to render the opinion concerning the propriety of expending reclamation funds to procure an option for certain lands needed for the project.⁵ The Comptroller reviewed the relevant language of the Reclamation Act (Act of June 17, 1902, 32 Stat. 388) which he quoted as follows (in relevant part):

'Sec. 7. That where in carrying out the provisions of this act it becomes necessary to acquire any rights or property, the Secretary of the Interior is hereby authorized to acquire the same for the United States by purchase ... and to pay from the reclamation fund the sums which may be needed for that purpose' ...⁶ (emphasis added)

He then went on to construe this language.

The Secretary of the Interior would have the right to purchase whatever rights or property that is necessary in his judgment to carry out the provisions of the act, and this would include the right to purchase 'a right of way, water right, or land needed for reclamation work' and to

pay for the same from the reclamation fund, but ... before he can legally pay for such rights or property, the ownership of such rights or property must vest in the United States. I do not think he would be authorized to contract and pay money for a mere option to purchase such rights or property ...⁷ (emphasis added)

In support of his opinion, the Comptroller cites several previous opinions which stand for the proposition that under Section 3648, Revised Statutes, advance payment by the Government on procurement contracts was prohibited.⁸ Nonetheless his opinions appeared to be grounded on a property concept as well. That is, an option, at least in the view of the Comptroller at the turn of the century, conferred upon the Government something less than rights in property. Perhaps in his opinion it conferred nothing until exercised.

A few years later, in 1916, the Comptroller of the Treasury was again called upon to decide an options issue.⁹ The amount in dispute was, almost incredibly, \$1. The opinion set forth the contract document in full:

On July 23, 1916, James Crawford executed the following paper:

'For and in the consideration of the sum of \$1, duly received, I hereby agree to hold for six months from date, at the option of the United States depot officer, El Paso, Tex., to purchase, at the prices hereinafter stated, the following ties and timbers now stored in the El Paso Milling Co. yards at El Paso Tex.'¹⁰

The Comptroller denied payment on the voucher quoting from his 1903 opinion, cited supra,¹¹ and stating:

I do not know of any authority of law for the purchase and payment of an option to purchase supplies. The policy of the Government as shown in the laws relating to the purchase of supplies is against any such expenditures and it should not be made ...¹²

The philosophical and legal underpinnings for these decisions required that payment for an option be conceptualized as an advance of public

money. Thus viewed it was clear that such an advance payment violated the relevant statutes relating to public moneys.¹³

But the Comptroller appeared to approve sub silentio, a Government requirements contract for hay which contained an option to increase or decrease the specified quantity by 20%.¹⁴ The issue in that case dealt with allowability of certain procurement costs, however there seemed to be no question that the Government acted properly in including an option in this contract.

Perhaps the thread of consistency can be found in the fact that the Government had not yet paid, but would do so only on delivery. Thus there was no question of advance payment in violation of statute. Also, perhaps more significantly, this case involved an option to procure an additional quantity beyond a basic quantity. The earlier Comptroller cases involved "naked" options that is, a contract in which there is no basic quantity, but only an option to procure in futuro a stated item or quantity.

The statutory language prohibiting advance payments of public moneys remains generally intact today.¹⁵ The only change is that the statute now permits advances if "authorized by the appropriation concerned or other law."¹⁶ Nonetheless the advance payment statute appears to be no impediment to including options in Government contracts. However, perhaps even today it could be argued that a Government procurement of a "naked" option, that is, an option contract in which there is no basic contract quantity, contravenes the law. Clearly the regulations talk in terms of options for "additional quantities" or which "extend the period of performance." Thus there may be no regulatory or statutory basis for procurement of a "naked" option by the Government. But no option cases appear subsequent to 1916 which apply this statute.¹⁷

B. Option Contracts to Increase Quantity

The first aspect contained within the definition of options involves conferring a unilateral right unto the Government to purchase additional quantities of supplies or services.¹⁸

1. The Foreseeability Issue

The regulations delimit the Government's ability to use increased quantity options somewhat. DAR 1-1502 illustrates this:

(a) Option clauses may be included in contracts if increased requirements within the period of contract performance are foreseeable ... [But] an option clause normally should not be included if it can reasonably be foreseen that (i) minimum economic production quantities will be required at some future date, and (ii) startup costs, production lead time, and probable delivery requirements would not preclude adequate competition. (emphasis added)

The Comptroller General has similarly applied a restrictive view of the use of increased quantity options. Thus where the Navy awarded a contract for hand lantern assemblies, retaining an option for 300% of the basic quantity, he stated:

It seems to us that the making of purchases in such a manner as to obligate the Government for less than the known quantity requirements of an item tends inevitably to result in higher unit prices than could be obtained for larger quantities of the item. An option of the character here involved is not, in our opinion, in the best interest of the Government if the known requirements exceed the minimum quantities upon which bids are solicited... Faced with such a requirement bidders must either include a "cushion" in their prices to take care of possible increases in production cost, or gamble that additional orders will be placed and figure their bid prices on more than the minimum quantities. The first alternative results in unnecessary increased cost to the Government, and the second alternative is unfair to bidders.

....
We realize that the inclusion of option clauses in

invitations is sanctioned by the Armed Services Procurement Regulation.... ASPR ... provides that such clauses may be used where increased requirements 'within the period of contract performance are foreseeable.' We do not believe this language was intended to apply in a situation where increased requirements are actually known rather than foreseeable...¹⁹ (emphasis added)

Shortly thereafter, the Comptroller General again had an opportunity to decide a question on the use of options. Foreseeability of need was once more the touchstone.

Since it would appear that additional requirements in the instant procurement are reasonably certain, you may wish to consider the advisability of requesting bids on both the known requirements and on amounts sufficient to include the estimated additional requirements, in order to obtain for the Government the benefits of any decreases in unit prices which might result from bids based upon such greater quantities. In the event additional requirements are not firm at time of award, it would appear that provision might also be made for subsequent addition of such requirement, to the contracts awarded, and for adjustment in the unit prices to correspond to the unit price bid on the total amount finally produced under each contract.²⁰

Black's²¹ defines foreseeability as "the ability to see or know in advance ..." This pretty well comports with the common-sense understanding of the term, that is foreseeable means generally predictable. But the Comptroller General appears to have applied a different meaning.

[A]n option contract, is described in ASPR 1-1501 et seq. This is intended for use in the case of either advertised or negotiated procurement of items not readily available on the open market, where requirements for the quantities beyond the minimum are foreseeable (which we take to mean possible or likely but not firm or definite) ...²²

GAO then has endeavored to draw a fine line beyond which additional quantity options are improper by thus defining foreseeability. Whether or not a need for additional quantities is characterized as likely rather than definite would seem to be a rather tenuous basis upon which to grant or deny a protest. It would seem that virtually all long term needs are

merely likely. Clearly requirements and programs change over time. Who better than the CO should make the decision as to whether the additional items are a proper subject for concurrent procurement or as part of an increased quantity option.

2. The "Appropriateness" of an Indefinite Quantity Contract

Increased quantity options are not to be used if an indefinite quantity contract is appropriate.²³ Indefinite quantity contracts are described in DAR 3-409.3. Subsection (b) thereof sets forth their applicability as follows:

An indefinite quantity contract may be used where it is impossible to determine in advance the precise quantities of the supplies or services that will be needed by designated activities during a definite period of time and it is not advisable for the Government to commit itself for more than a minimum quantity. Advantages of this type of contract are:

- (i) flexibility with respect to both quantities and delivery scheduling
- (ii) supplies or services need to be ordered only after actual needs have materialized;
- (iii) the obligation of the Government is limited; and
- (iv) it permits stocks to be maintained at minimum levels, and allows direct shipment to the user.

The indefinite quantity contract should be used only when the items or service is commerical or modified commerical in type and when a recurring need is anticipated.
(emphasis added)

This language seems to indicate that an indefinite quantity contract is appropriate where there is a potential need beyond a minimum quantity, but only for commerical or modified commerical items. Compare the limitation on use of options found at DAR 1-1502(b)(i) that options shall not be used if the items are readily available on the open market. These appear to be congruent rules, although it might be argued that there is a difference between commerical items and items readily available on the

open market. For example, recall that hand lantern assemblies costing about \$3 apiece were the subject of an option contract. These apparently were not available on the open market.²⁴ But diesel generators costing thousands of dollars each were characterized as commercial items thus properly the subject matter of an indefinite quantity contract.²⁵

a. Characteristics of Indefinite Quantity Contracts

Although increased quantity options are similar in many respects to indefinite quantity contracts they are not alike. The Comptroller General pointed out the distinction as follows:

While we agree that in ordinary usage there is no real distinction between a contract including an option for an additional quantity and an indefinite quantity contract permitting the purchaser to order quantities beyond the minimum required - and we used the terms interchangeably in 41 Comp. Gen. 682 - it is apparent that the two expressions are employed in ASPR as particular terms of art to distinguish between two different kinds of options contract. The first, designated as an option contract, is described in ASPR 1-1501, et seq. This is intended for use in the case of either advertised or negotiated procurements of items not readily available on the open market, where requirements for the quantities beyond the minimum are foreseeable ... and where later orders may represent less than minimum economic production quantities which, considering start-up costs, production lead times, etc, could preclude adequate competition ...

On the other hand, the indefinite quantity contracts described at ASPR 3-409.3 are for use only in negotiated procurements of commercial or modified commercial items. The regulation contains no limitation on time or quantity under this type of option and it is significant that we have not objected to such limitations ...²⁶ (emphasis added)

It would appear then, that in the view of GAO the difference lies in the fact that the regulations discuss these contract types under different sections, creating a distinction merely by definition.

Additionally, the Comptroller General points out that indefinite quantity contracts are to be used in negotiated procurements only. Thus,

by definition, a contract containing a provision for increased quantities must be an option contract if awarded pursuant to advertising procedures. Said differently, unless negotiation is otherwise proper, use of an indefinite quantities contract would seem to be inappropriate. But where the question arises in a negotiated contract, resort to the distinction between commercial and non-commercial (or, perhaps, not available on the open market) items appears to be determination of when an indefinite quantities contract is appropriate.

1). Indefinite Quantity Contracts Compared to Requirements Contracts

The most practically significant characteristic of the indefinite quantity contract is the minimum quantity.

The contract shall provide that during the contract period the Government shall order a stated minimum quantity of the property or services and that the contractor shall furnish such stated minimum and, if and as ordered, any additional quantities not exceeding a stated maximum which should be as realistic as possible ...²⁷

It is the minimum quantity provision which distinguishes indefinite quantity contracts from requirements contracts. This is a crucial distinction from the Government's standpoint; the latter contract-type binds the Government to order its requirements from a particular source and can provide remedies for faulty quantity estimates. But the indefinite quantity contract, like the increased quantity option, binds the Government only to a minimum order after which it is free to look elsewhere to satisfy its needs.

Thus a contractor's claim for compensation based on the Government's failure to order an estimated quantity of 500 units was denied by the ASBCA where the contract was held to be an indefinite quantity contract with a minimum quantity of 225 units.²⁸ The contract in question

contained the following clause:

INDEFINITE QUANTITY (AUG 1965)

(a) This is an indefinite quantity contract for the supplies or services specified in the Schedule and for the period set forth therein. Delivery and performance shall be made only as authorized by orders issued in accordance with the 'Ordering' clause of this contract. The quantities of supplies or services specified herein are estimates only are not purchased hereby

(b) ... The Government shall order the quantity of supplies or services designated in the schedule as the 'minimum.'²⁹

The board, in declining to grant relief, distinguished indefinite quantity contracts as follows:

The indefinite quantity contract, including the minimum and maximum quantities, is a special kind of option contract under which the Government is bound to order and receive the minimum quantity and cannot be required to take more, but may require the contractor to deliver up to the maximum quantity....

Under an indefinite quantity option contract the contractor is guaranteed orders for the basic or minimum quantity. There is no promise or legal obligation on the part of the Government to satisfy its requirements for this type of services or supplies from the available options ... The holder of an option contract is thus from the outset put on notice of the risk it would assume in relying on the maximum quantity estimate for pricing purposes.³⁰

The Board held that the Government's use of "estimated quantity" of 500 in place of a maximum quantity lent credence to the argument that this was a requirements contract. However the plain language of the contract as a whole led to the opposite conclusion. Further, absent a showing that the estimated quantity was negligently computed no relief would be allowed even if this had been a requirements contract.

Conversely the Court of Claims held, in Neil A. Goldwasser v. U.S., that a contract which contained an "Indefinite Quantities" clause was nonetheless a requirements contract thereby providing the contractor a remedy where the Government stopped using the contractor's service after

ordering only the minimum quantity.³¹ The relevant contract language there read:

INDEFINITE QUANTITIES

The total quantities specified herein are estimates only. The amounts which the Contractor may be required to furnish and the Government to accept hereunder shall be the amounts which shall from time to time be ordered hereunder by the Government during the ordering period of this contract. In any event, however, the Government shall order supplies (or services) hereunder having an aggregate value at the unit prices specified herein of not less than \$100,000; and the Government shall be entitled to order and the Contractor shall be required to furnish supplies (or services) hereunder amounting to not more than the total estimated quantities set forth herein.³²

However the contract also contained language which the court construed as indicative of a requirements contract.

To set type, proofread, make up, submit galley proofs and page proofs, and print in one color ink, fold, insert, and deliver: 50 Issues (about 750,000 copies)

....

Minimum numbers of copies to be printed under this contract shall be 10,000 per issue ... reserving the right to add increments of 1,000 up to a total of 30,000 copies per issue...³³

The Court like the ASBCA in the previous case, faced with the task of determining the nature of the contract, looked to the intent of the parties. But here more than contract language was reviewed. The Court determined that the parties "envisaged a relatively long-term relationship between them."³⁴ That the contract was for printing services which were to be provided for a year was significant in the Court's view.

[N]othing in the facts supports the idea that they intended that relationship to subsist only occasionally and at defendant's election.

In Tennessee Soap Co. v. United States, 130 Ct Cl. 154 (1954), 126 F. Supp. 439 (1954) ... The commercial setting was such that an indefinite quantities contract made sense. In that case, it was clear at the time the contract was made that the Navy's need for soap was uncertain; though it obviously would need some soap over the course of the

contract, the Navy had no idea just how much it would need or when it would want delivery to be made. In such a situation, the indefinite-quantities clause fits the situation; it enables the Government to procure needed supplies but does not commit it to buy too much or at the wrong time. In the case at bar, however, the minimum quantity of the (newspaper) that would be needed and the times of delivery were known to (the Government) in advance. Since the contractor was obligated to furnish this minimum number, the Navy, on the other hand, must be held to have been obligated to accept this minimum number.³⁵

The court also pointed out the fact that the minimum quantity obligation was only \$100. This it viewed as bordering on lack of mutuality.³⁶

The Court of Claims had further occasion to consider this issue in James Mason v. United States.³⁷ The contract there was for painting and plastering services. It contained a clause which stated that the services would be furnished by "a single contractor at the unit prices established ... in quantities ... as may be required from time to time..."³⁸ The contract contained a guaranteed minimum quantities clause stating that the minimum quantity of work ordered would be at least \$5000.

This time, the Court did not go outside the contract language in deciding the issue. Rather it held that the "Guaranteed Minimum Quantity" clause would be rendered meaningless if the contract were construed to be a requirements type. On that point the court held:

In a requirements contract, the seller's promise to satisfy the buyer's requirements and the buyer's promise to purchase all its requirements from the seller ensure mutuality of obligation. 1A. Corbin, Contracts §156.... Without more, such a contract is fully enforceable by buyer and seller. A guaranteed minimum quantity purchase amount would add nothing to enforceability of a requirements contract. A guaranteed minimum purchase amount is, however, essential to there being an enforceable indefinite quantities contract....

...Assuming, as we must, that the Government possesses

at least minimal business sense, ... it must realize that to induce people to place bids, it would have to ensure that the successful bidder receives at least (enough work to cover bid expenses) ...

These term contracts each covered a fairly large geographical area and a large number of construction projects. If these were requirements contracts, the recipient of each of these would be given the exclusive right within this area to perform all the described work. In view of the large amount of work which the Government needed done (fn deleted), such contractor, even in the absence of a guaranteed minimum amount of work, would be assured of enough work to induce its bid. However, if these were indefinite quantities contracts, to ensure that bids would be received, a guaranteed minimum purchase amount would be needed....

All six of these contracts contain a Guaranteed Minimum Quantity clause. Such a clause can serve only two possible purposes - to ensure mutuality of obligation, and to make the contract enforceable by both parties to it; and by promising a minimal level of work, to allow recovery of bid expenses and thus induce contractors to bid on the contract.

The Guaranteed Minimum Quantity clause would be given legal meaning and serve a purpose only if these are indefinite quantity contracts...³⁹

It is difficult to reconcile Mason with Goldwasser. In Goldwasser, although the court gave the issue rather short shrift, the fact that the minimum quantity was only \$100 was probably decisive. This is brought home rather clearly by the attention which the Mason opinion devotes to a minimum quantity being representative of the business inducement to cover bid expenses. Thus perhaps in spite of the language in both cases which discuss the intent of the parties, the real touchstone is the minimum quantity. The rule, then, would appear to be that where the contract can reasonably be interpreted to be an indefinite quantity type it will be, absent lack of mutuality of obligation. Mutuality of obligation is tested by looking at the minimum obligation the Government has under the contract. Where mutuality is arguably lacking, to preserve a contractual nexus the court will endeavor to find a requirements contract.

b. Basic Ordering Agreements

A peculiar variant of the indefinite quantity contract is the Basic Ordering Agreement (BOA).⁴⁰ This method of procurement is described at DAR 3-410.2(a) and (b) (in relevant part) as follows:

a. A basic ordering agreement is not a contract.... It is an agreement which is similar to a basic agreement (see 3-410.1) except that it also includes a description, as specific as practicable, of the supplies to be furnished or services to be performed when ordered and a description of the method for determination of prices to be paid to the contractor for the supplies and services ...

b. ... The basic ordering agreement may be used as means of expediting procurement where specific items, quantities, and prices are not known at the time of execution of the agreement but where past experience or future plans indicate that a substantial number of requirements for items or services of the type covered by the basic ordering agreement will result in procurements from the contractor during the term of the agreement. (emphasis added)

The employment of BOA's is limited to situations in which it is determined at the time the order for the supplies or services is placed that it would be impracticable to obtain competition either by negotiation or formal advertising.⁴¹

The Comptroller General has held that a BOA is not illegal merely because the terms and conditions of agreements reached thereunder may vary with each firm.⁴² This is consistent with the basic notion that a BOA itself is not a contract, but rather a means of assuring the Government a source of supply.⁴³ The cases which have arisen out of use of BOA's have generally involved protests by firms not having BOA's but which seek to be included in competitive procurements for supplies or services covered thereby.

Much like exercise of options, before placing an order under a BOA a competitive solicitation is mandated unless impracticable.⁴⁴ (See Ch

III, Sec A) This appears to be true notwithstanding that more than one firm has a BOA.⁴⁵ It also appears that formal, written solicitations must be used rather than informal efforts to "test the market."⁴⁶ The distinction apparently lies in characterizing attempts to limit the field of offerors to those holding BOA's as a form of prequalification. GAO commented thusly concerning this issue:

In view of the foregoing, we believe that FAA's conducting an informal competition for an order to be issued under one of several vendor's BOA's without the issuance of an adequate written solicitation was a procedure at variance with the fundamental principles of Federal negotiated procurements. In addition, we believe there is a further question concerning prequalification of offerors if a competition of this type is limited to vendors having BOA's. In this regard, in several instances our Office has tentatively approved special agency procedures in which competition for a contract is limited to offerors which have previously entered into certain types of agreements with the agency ... However, absent such special circumstances, the general rule is that prequalification of offerors is an undue restriction on competition. [citing, inter alia] ASPR 3-410.2(c)(2), which provides that the choice of firms to be solicited is to be made in accordance with normal procedures and without regard to which firms hold BOA's.⁴⁷

Thus a characteristic which rather clearly distinguishes BOA's from options is perhaps more closely aligned to exercise, but is significant in an analysis of applicability as well. The BOA is not a contract and, generally speaking, can not become one short of the formal process of solicitation underlying all procurements. What, then, is the usefulness of such a device?

In one opinion the Comptroller General stated that BOA, while not itself a contractual commitment, did provide the Government the means of securing additional supplies to meet peak requirements.⁴⁸ Arguably this presupposes that the Government may be faced with a situation in which it is impracticable to obtain competition when the need for the

supplies arises.⁴⁹ Only in such circumstances does it appear that orders may be placed against BOA's without first soliciting other potential offerors.

The Comptroller General has had occasion to decide, at least tangentially, when the standard of DAR 3-410.2(c)(2)(i), permitting ordering against a BOA without solicitation, has been met.

A BOA may be used to expedite procurements where specific items, quantities, and prices are not known when the BOA is executed and where procurement of parts under a BOA can be administratively and financially advantageous because the procedure reduces both the amount of inventory kept on hand and the administrative time required to place items in a production status. ASPR 3-420.2(b). The content and use of such agreements are subject to a number of limitations. A BOA is not a contract, it cannot provide or imply that the Government agrees to place future orders or contracts with the BOA contractor. Most important, it cannot be used in any manner to restrict competition ... The issuance of orders under a BOA is [may be placed only]:

(1) If it is determined at the time the order is placed that it is impracticable to obtain competition by either formal advertising or negotiation for such supplies or services ... (emphasis in original)⁵⁰

In this case the Navy entered a BOA with Sikorsky for certain spare parts for helicopters which Sikorsky had built. A protester, Rotair Industries, alleged inter alia that the Navy had improperly assigned procurement codes to the various spare parts permitting procurement only from the original manufacturer. The Navy argued that this coding was a reasonable exercise of procurement authority and that the time it would take to review and change the codes would make such action impracticable for in-progress replenishment transactions. But the Comptroller General held that the Navy's reliance upon the impracticability associated with changing procurement codes was misplaced. There is no prohibition in the regulations of solicitations of unapproved sources. There was no showing that, other than because of the arguable administrative difficulty of

changing parts codes, that procurement from Rotair or others would be impracticable.

Although the Comptroller General did not go so far as to define impracticability in this context, it would appear to go to expediency. Thus where, because of time constraints competition cannot be carried out, the regulations permit orders against BOA's. Further, this determination of impracticability must be made at the time which orders are placed against the BOA.⁵¹

The BOA, offering the potential use as a prequalification device, provides a fertile grounds for protests to flourish.⁵² Conversely, use of an indefinite quantity contract was upheld over a protest that the proper contract format for the subject matter was a BOA.⁵³ In deciding that issue, the Comptroller General pointed out that the Navy had determined that it was practicable to compete sources for its needs, hence a BOA would be of no value. The protester found little solace in DAR 4-803.6, Placing Advertising Through Advertising Agencies, which states in relevant part:

Basic ordering agreements may be entered into with advertising agencies to provide advertising services....

The Comptroller General held that this provision merely permitted use of BOA's, it did not mandate their use. The Navy properly chose the contract format best suited to its use.

Thus, although the BOA can be used where the Government has potential increased quantity needs, its use is rather substantially circumscribed.

C. Option Contracts to Extend Performance Period.

The second broad aspect embodied in the definition of options is that the Government may elect to extend the period of performance of a contract thereby. Options to extend the performance period can be included where it is in the Government's best interest to do so.⁵⁴ Whether or not the Government's best interests are served often becomes a question of whether or not another contractual device to extend performance is more suitable than an option to effectuate the Government's procurement needs.

The Comptroller General illustrated this point in an early decision.⁵⁵ The Secretary of the Interior asked whether or not he could award a cement contract to run some three and one-half years covering construction needs for the Owyhee Dam in Oregon. If the contract could be let in that manner a savings of about 10 cents per barrel would be realized when compared to procuring in annual increments. The then relevant statute read as follows:

[E]xpenditures shall not be made for carrying out the purposes of the reclamation law except out of appropriations made annually by Congress therefor ...⁵⁶

In answering the question in the negative, the Comptroller General stated:

It may be stated, in conclusion, that there is no legal objection to acceptance of the low bid for delivery of 75,000 barrels of cement during fiscal year 1930, with an option in the United States, subject to appropriations being made, to require the delivery of 425,000 barrels additional apportioned over the remainder of the fiscal-year periods necessary for the construction of the dam but with notice to the contractor that such option will be exercised only in event the advertisements for proposals at the beginning of each succeeding fiscal-year period should fail to elicit proposals lower than the option price stated in the contract.⁵⁷

Similarly, in a somewhat more recent case the Comptroller General

viewed a three year contract for aircraft supplies and services at Wake Island to be violative of fiscal year funding limitations.⁵⁸ However, again it was suggested that this procurement could be undertaken by means of renewal options from year to year. After reciting various statutes which establish fiscal year limits on contractual authority⁵⁹ the Comptroller General observed:

These statutes evidence a plain intent on the part of the Congress to prohibit executive officers, unless otherwise authorized by law, from making contracts involving the Government obligations for expenditures or liabilities beyond those contemplated and authorized for the period of availability of and within the amount of appropriation under which they are made; to keep all the departments of the Government, in the manner of incurring obligations for expenditures, within the limits and purposes of appropriations annually provided for conducting their lawful functions, and to prohibit any officer or employee of the Government from involving the Government in any contract or other obligation for the payment of money for any purpose, in advance of appropriations made for such purpose; and to restrict the use of annual appropriations to expenditures required for the service of the particular fiscal year for which they are made.⁶⁰

In spite of the Air Force's urging that no funds beyond the current fiscal year could or would be committed without an affirmative order for services, the Comptroller General decided that this contract violated the above referenced statutes.

The Department justifies the continuing liability terms of the contract on the basis that such liability does not result in appropriation obligations ... until orders are issued under future available appropriations.... [U]nder the holding of the Leiter case, the contract ceases to exist at the end of the fiscal year current at the time of its execution and affirmative action is required to renew the contract.⁶¹

Elsewhere in the decision the Comptroller General stated:

[E]ven where the contract contains an option in the Government to renew from year to year to the end of the stated term contingent upon the availability of future available [sic] appropriations, affirmative action, in effect making a new contract and complying with the

advertising requirements, is required in order to exercise the Government option of renewal.⁶²

Thus the fundamental concept here is that the option to extend the performance period provides the Government a means of doing what it may otherwise be unable to do. Through the inclusion of options, contracts can, in form at least, be made to cover procurements extending over several fiscal years. Of course there are strict limitations on exercise of such options which can require re-solicitation prior thereto. (See Ch III, Sec A)

1. Options to Extend the Performance Period Compared to Multiyear Contracts

Another procurement format which endeavors in part to achieve a similar purpose is multiyear contracting. Although in many ways more closely aligned to requirements contracts multiyear contracts share certain characteristics with options to extend performance.

For example, the Comptroller General held that a solicitation for a three year quantity of aircraft instruments was properly evaluated as a multiyear procurement rather than as a one year contract with an option to extend for two additional years.⁶³ The Comptroller General found persuasive the fact that funding for the three year quantity would be from appropriations not limited by statute for obligations during the fiscal year in which the contract is executed. And, although the last two years' quantity was unfunded at time of evaluation, the likelihood of funding was substantial.

But the Comptroller General distinguished options in another way for this purpose:

[I]n the former (case) there was involved a commitment for actually determined requirements with an option

provided for future requirements as might materialize, whereas in the immediate case the invitation reflects an intention to make award for the actually determined requirements, delivery of which is required to be made in definite increments at times specified in the delivery schedule provided in the invitation for each of the 3 years involved... It seems quite clear that in the immediate case the Government has scheduled very definite requirements for the 3 years involved with only a remote possibility that those requirements may not be funded and that the provision for termination for the succeeding years after the first was included to make clear in advance what the Government's liability would be in the event the Government chose not to complete the entire contract and to terminate it.⁶⁴ (emphasis added)

It would appear that in the view of the Comptroller General that aside from the clear requirement to comport with fiscal statutes the significant characteristic of options when compared to multiyear contracts is that the option merely contemplates future requirements which might materialize. This was clearly iterated in a seminal multiyear contract decision wherein the Comptroller General approved of the use of this contract type as follows:⁶⁵

[A] method for competitive contracting for known requirements ...

Cancellation of the contract would occur upon notification to the contractor that funds were not available for subsequent program years or upon failure to notify the contractor of the availability of funds by a specified time ...

The multiyear procurement procedure, however, would not be used where funds covering the procurement are limited by statute for obligation during the fiscal year in which the contract is executed. In other words the funds obligated thereby are no year funds.⁶⁶

Multiyear contracts, like options, are not to be used for generally available commercial items. But the underlying rationale which supports this rule may be different for each of the two contract types. Multiyear procurements exist

[A]s a means of securing for the Government benefits that could not be derived by contracting solely on a fiscal-year basis.... [I]t would be used only where competition

procedures that reduced prices would result over annual buys by reason of the elimination of repetitive, substantial start-up costs.... Such cost benefits generally do not exist where the Government is purchasing commercially available 'off the shelf' merchandise...⁶⁷

Multiyear procurement ideally at least, is used where start-up costs are high and contractors might otherwise be unwilling to risk recovering such costs under repetitive annual procurements. The cancellation charge is an effort to provide contractors the requisite financial certainty to enter the market.

Conversely, the option contract regulations,⁶⁸ proscribing use of options for items which are readily available on the open market, would seem to merely embellish the theory that an option should not be used if competition would be limited thereby. Thus both contract types are unsuitable for commercial items, but for different reasons. Multiyear contracts encourage capital investment while extension options are, to some degree, anti-competitive.

Hence, although multiyear and extension option contracts might appear almost identical, they are not. This was emphatically stated by the ASBCA when deciding that the Government could not merely decide not to buy a subsequent year's requirements under a multiyear contract as it might under an extension option.⁶⁹

[M]ultiyear procurements are not option or call contracts, which are separately provided for in ASPR, consequently such contract 'does not afford to the Government the election to buy or not to buy any year's requirement on the basis of the condition of the market' ...

We conclude that funding successive program year requirements is mandatory under the language of Clause 57 ... with two exceptions.⁷⁰

The Board pointed out that the two permissible exceptions which would allow the Government to terminate a multiyear contract were cancellation of the requirements and nonavailability of funds. Neither of these are

in the realm of subjective actions. Rather they are objectively determinable, binding the Government to perform so long as the conditions permitting cancellation do not inhere.

ITT Federal Laboratories may best illustrate the potential for confusion between extension options and multiyear contracts. In that case it was argued that the Government gave improper notice of funds availability thus the contractor contended that its obligations to continue performance in successive years ceased. The issue, at least as the case was postured to the ASBCA,⁷¹ was whether or not this was an option contract. On that point the Board held:

Because appellant so vigorously asserts that classification of the contract as an option contract is controlling of strict, if not hypertechnical, interpretation for which it contends, and because we think that an appreciation of the fundamental nature of the arrangement is germane to a relaxation of the rules of strict construction, we set forth here our views with respect to the nature of the contract. From the contract itself, and from its administrative history, as reflected in ¶1-322 of ASPR and the relevant decisions of the Comptroller General, it is clear that appellant intended to commit itself to furnish to the Government the stated quantities of the specified items during a multiyear period of a level price and that the Government intended to obligate itself to buy each successive fiscal year requirement from the appellant or, in the alternative, pay a cancellation charge. This change was specifically designed to protect appellant from loss by allowing reimbursement for unrecovered, preproduction and other nonrecurring costs on cancelled items ...

In its details the contract in some respects is not unlike an indefinite quantities requirements contract ... Here, however, the additional quantities were not indefinite or optioned but fixed amounts which the Government was obligated to buy in full each year unless it cancelled the contract in its entirety. Despite colloquial references to such contracts as 'options,' they are not entered into under the ASPR provisions for options or call type contracts but as contracts for fixed quantities which the Government is obligated to purchase subject to the availability of funds. [6]

[6] Multi-year contracts are thought to be substantially different from option contracts in procurement purpose, are separately provided for in the detail set out in ASPR 1-322, and have been specifically

approved and authorized for use by the Comptroller General.... A significant difference for present purposes is the fact that the multi-year contract does not afford to the Government the election to buy or not to buy any year's requirement on the basis of the condition of the market.⁷²

The Board characterized the contract as multiyear, hence found notice to be adequate and the contractor bound to perform. The case was subsequently tried by the Court of Claims and reversed.⁷³ The court held that notice was nonconforming without deciding the issue of contract type. But reversal notwithstanding, the Board's efforts to distinguish options from multiyear contracts is instructive.

Thus although similar at first blush, extension options and multiyear contracts are fundamentally distinct. Not only do they provide substantially different rights and remedies, but their respective use appears to be limited to completely different purposes. The extension option is not applicable where the Government has known requirements which will carry over several years; multiyear contracts probably provide a more sound procurement mechanism for that purpose.

2. Options to Extend the Performance Period Compared to Options to Renew the Contract

There appears to be a distinction between options to extend the period of performance and options to renew the contract, as least in general contract usage:

Generally an option to renew a contract is the right to require the execution of a new contract while an option to extend the term merely operates to extend the term of the original agreement⁷⁴

This distinction, if it exists in Government contracts, was examined in the context of applicability of the Service Contract Act⁷⁵ to pre-Act contracts containing options which were exercised after the

effective date of the Act. The relevant language of the Service Contract Act, set forth in 48 Comp. Gen. 719 (1969) as follows:

Sec 9. This Act shall apply to all contracts entered into pursuant to negotiations concluded or invitations for bids issued on or after ninety days from the date of enactment of this Act [January 20, 1966].

In that case, a postal service contract contained an option to extend the performance period for six months. The extension option permitted the Postmaster General to continue in force existing contracts under essentially the same terms and conditions as the underlying contract. Thus the question became whether or not such extension pursuant to the option created a new contract subject to the Act.

The Comptroller General, after distinguishing extension and renewal options as set forth at 17A C.J.S. Contracts §449, stated:

Under this rule we believe that exercise of the authority of the Postmaster General to 'continue in force' any regular contract 'until a new contract is made' could not be considered as creating a new contract.⁷⁶

However, if there is a theoretical difference between these option types, there may not be a practical difference. DAR 12-1005.7(b) illustrates this:

Extension of Contract Through Exercise of Option or Otherwise. A new contract shall be deemed entered into for purposes of the Act when the period of performance of an existing contract is extended pursuant to an option clause or otherwise.

Thus, at least for purposes of Service Contract Act application, options to extend and to renew are treated identically. Nonetheless absent special treatment under the regulations the technical distinction would probably remain viable.⁷⁷

3. Options to Extend the Performance Period: Issues Concerning ADPE Procurement

Generally in the context of ADPE, the lease-purchase option and the lease with renewal option arise as management alternatives to outright purchase of the equipment. Another alternative but which was found to be lacking legal sufficiency was purchase on an installment basis. This proposal called for the agency to make a down payment of ten percent, then pay the remaining balance over several years. The proposal also called for the equivalent of cancellation charges if the Government terminated the contract prior to full payment. The Comptroller General viewed that purchase arrangement with suspicion:

The proposal to sell the equipment to the Government with payment therefor to be made over a period of years is a proposal for a sale on credit. It thus contemplates a contract extending beyond the current fiscal year and would continue as such unless affirmative action is taken by the Government to terminate. This ostensibly is the only way such equipment can be purchased at this time because of insufficient funds. A purchase of the equipment under these circumstances in the manner proposed would be in direct conflict with sections 3732 and 3679, Revised Statutes, as amended, codified as 41 U.S.C. 11 and 31 id 665(a), respectively, which provides in pertinent part as follows:

No contract or purchase on behalf of the United States shall be made, unless the same is authorized by law or is under an appropriation adequate to its fulfillment...

....
No officer or employee of the United States shall make or authorize an expenditure from or create or authorize an obligation under any appropriation or fund in excess of the amount available therein...

The economic advantages of purchase over rental cannot be used to frustrate the statutory prohibition against contracting for purchases in excess of available funds...⁷⁸

A second ADPE acquisition proposal was similarly rejected by the Comptroller General in a companion case.⁷⁹ Under this alternative, GSA

sought to finance ADPE procurement by use of revolving funds which would be reimbursed by agencies ordering equipment through GSA. GSA's position was that substantial savings could be realized by entering long term leases and that restrictions on the duration of contracts should be lifted for this purpose. Also considered by the Comptroller General were rental proposals with minimum rental periods in excess of one year. None of these passed legal muster.

Leases of automatic data processing equipment under fiscal year appropriations must be restricted to the period of availability of the appropriations involved. With respect to the revolving funds we have no legal objection to contracting for reasonable periods of time in excess of 1 year subject to the condition that sufficient funds are available and are obligated to cover the costs under the entire contract ... Nor, as stated above, would we have any objection under revolving funds to contracts for a basic period with renewal options, provided funds are obligated to cover the costs of the basic period, including any charges for failure to exercise the options.⁸⁰

a. Lease with Renewal Option

Lease with renewal option thus emerged as an acceptable device by which the Government could economically procure ADPE given fiscal year funding constraints. But query whether or not such an alternative, practically speaking, truly gives the Government an option. It has been noted that the cost of installing ADPE is exceedingly high and carries with it a commitment to installed configurations.⁸¹ It could be convincingly argued that although the Government may indeed have an option to extend the term of the lease, the costs of not exercising make contract continuation almost inevitable.

Contracts which obligate fiscal year appropriations must be for bona fide needs of that fiscal year to be charged.⁸² In attempting to define this, the Comptroller General observed:

Determination of what constitutes a bona fide need of the service of a particular fiscal year depends in large measure upon the facts and circumstances of a particular case. No general rule can be stated for application to all situations which may arise.... When a continuing supply of materials is needed over a period of time, the contract term may not exceed one year, and only the needs of the first fiscal year may be considered a bona fide need of the year in which the contract is made.

The situation not infrequently arises in the case of requirements for water, gas, electricity, or other utilities that there is only one reasonable source of supply and the furnishing of the service needed requires the construction of a new line to the Government project.... Under such circumstances, and where the contractor is unwilling to build the required new line at its own expense without assurances that it will be able to recover the capital cost involved, we have approved arrangements ... [such as] (1) payment to the contractor of the cost thereof at the beginning of the contract, with or without rebates from subsequent bills for services, or (2) contract provisions for cancellation charges contingent upon failure to renew the contract from year to year.... [Subject, of course, to the condition that an amount equal to the maximum contingent liability of the Government is always available for obligation from appropriations current at the time the contract is made and at the time renewals thereof are made.⁸³

Clearly, if a lease contract contains renewal options with provisions for "cancellation charges" upon non-exercise such charges must be examined in light of the cited limitation. The Comptroller General had occasion to review such contracts in Burroughs Corporation⁸⁴ and Honeywell Information Systems, Inc.⁸⁵

In Burroughs, the Mine Enforcement and Safety Administration (MESA) of the Department of Interior issued an RFP for acquisition of ADPE for a proposed 65-month period if all options to continue the lease contract were exercised. Funding was by fiscal-year funds. Offers were to be evaluated based on lowest price for basic plus option periods. The contract, awarded to Honeywell, provided for "separate charges" if the use of the system is terminated prior to its intended systems life. The relevant contract language read as follows:

While the Government is not obligated to exercise its options to extend the term of this contract for the full 60-month system life, the parties hereto acknowledge that the stated prices and discounts and other terms and conditions are based on the Government's current intention to so extend the term of this contract. Accordingly the Government agrees that for each proposed item of equipment not purchased or rented or retained on rental for the entire 60-month system life or respective remaining portion thereof, the Government shall pay to Honeywell an 'Early Lease Termination Charge' of 30% of the monthly list rental price ... multiplied by the remaining number of respective months until the end of the 60-month system life. Thus, if an item is returned to Honeywell 15 months prior to the end of the 60-month system life period, the Government shall pay to Honeywell an 'Early Lease Termination Charge' of 4-1/2 month's rent at list rental price...⁸⁶

Honeywell and indeed the Comptroller General took the position that inclusion of these separate charges was essentially invited by language found in the solicitation.

II.2.2. EVALUATION OF PRICES

Offers will be evaluated for purposes of award by adding the total price of all optional periods ... Separate charges, if any, which will incur to the Government should the latter fail to exercise the option, will not be considered in the evaluation except as stated II.2.3 below (emphasis supplied)

II.2.3. UNBALANCED PRICES

In determining an offer which is unbalanced as to prices, the Government will evaluate separate charges, if any, which the Government will incur for failure to exercise the options.

Because these separate charges potentially involved the obligation of funds beyond fiscal year appropriations the Comptroller General applied the principles set forth in 37 Comp. Gen. 155, cited supra. There it was held that certain termination charges represented a part of the price of future rather than current needs. Thus such charges exceeded the authority of the Government to pay. In Burroughs, the Comptroller General similarly found the separate charges to represent ADPE requirements for future years rather than current needs.

Honeywell's separate charges penalty is clearly intended to recapitalize the contractor for its investment based upon a full 60-month systems life if the Government fails to continue to use the equipment. Indeed Honeywell's penalty is a percentage of all future years' rentals of discontinued system equipment based on Honeywells 'list prices' at the time of discontinuance.... If the Government were liable for the charges involved it is apparent that the Government's option 'rights' under the Honeywell contract are essentially illusory, since the Government would have to pay a substantial penalty in lieu of exercising the option.

Honeywell's separate charges, therefore, do not reasonably relate to the value of the current fiscal year requirements which have actually been performed. Consequently, the charges are not based on a current fiscal year need, and payment of those charges would violate [31 U.S.C. 665(a); 31 U.S.C. 712a; and 41 U.S.C. 11].

....

Furthermore, if the Honeywell contract were terminated for the convenience of the Government, it seems that payment of the Honeywell separate charges would be inconsistent with the standard termination for convenience (T for C) clause remedy. This clause was included in the Honeywell contract by requirement of Federal Procurement Regulations (FPR) §1-8.700 (Amend. 153, 1975).

The Honeywell separate charges do not represent costs incurred in the performance of work terminated - the measure of recovery under this clause. Moreover, these charges would clearly exceed the value of the contract - the limit of recovery under the clause - if complete termination of the system occurred during the first few years. Consequently, payment of the Honeywell separate charges would allow for recovery of costs not cognizable under the T for C clause.

... In any case, by virtue of the RFP's Order of Precedence clause, the T for C clause here clearly takes precedence over the separate charges provision.⁸⁷

The companion decision, Honeywell,⁸⁸ considered similar facts. In Honeywell an ADPE contract with option periods extending up to 96 months was to be funded by fiscal year funds. Honeywell protested GSA's imposition of separate charges contained in Honeywell's best and final offer. This best and final offer was expressly based upon the assumption that the entire contract period would be 96 months and contain an "Early Lease Discontinuance Charge."

The Comptroller General, citing the decision in Burroughs,⁸⁹

concluded that this separate charges scheme ran afoul of statutory restrictions. As in Burroughs the Honeywell decision is critical of the Fixed-Price Options clause set forth in the then current FPNR.⁹⁰ Likening the clause's permissible evaluation of separate charges if unbalancing is present to the confusion caused by the generally vague definition of unbalancing in Mobilasee,⁹¹ the Comptroller General recommended the clause be redrafted.

More significantly Burroughs and Honeywell set forth guidelines by which it would be permissible to provide for "separate charges" upon failure to exercise an option to continue a contract.

To be contrasted with the improper Honeywell scheme, the Government may properly pay a higher base rate for the first year than subsequent years of multiple year requirements covered by the same procurement funded with fiscal year appropriations. Award may be made under the circumstances set out in FPNR §101-32.408-5 to an offeror proposing the lowest overall price adding the base contract price and the prices of all options intended to be eventually exercised, rather than to the offeror proposing the lowest initial price for the base contract period only.... Award, in effect, is to be made to the offeror proposing the lowest overall average price for the projected contract life - assuming that there is a reasonable certainty that the options will be exercised. So long as the lowest overall offer is not 'unbalanced' - e.g., based on prices significantly understated for some work and overstated for other work - any part of the higher initial contract price for the base period does not represent future year needs, since award, in fact, is being made to the lowest bidder for the entire intended contract term.... on the other hand, separate charges which do not represent the reasonable value of the performed work at termination - e.g., Honeywell's separate charges - can be directly linked to future year needs, since the charges actually compensate the contractor for the Government's failure to use the equipment in future years. Moreover, separate charges cannot be logically added to the base and option prices to determine the lowest-priced offer, since both these prices and the separate charges will not be paid because they are alternative in nature.⁹² (emphasis added)

Thus it seems that the Comptroller General did not completely close the door on the use of separate charges in lease extension options. But

where the separate charges take the form of greater base year charges, award is appropriate only where there is an expectation that the option will be exercised. Permitting higher base year costs clearly gets around the problem of committing current fiscal year funds for future years' needs. However the question remaining becomes essentially an evaluation of offers issue: when is there a reasonable certainty that options will be exercised? This, it appears, lies within agency discretion at time of initial evaluation, depending in large part on the agency's determination of future funds availability.⁹³

Additionally the Comptroller General appears to approve of separate charges which do represent the reasonable value of performed work at termination as properly chargeable where an extension option is not exercised. Although charges thus isolated are consistent with fiscal year constraints applicable to contract continuation, any additional expense to the Government based upon nonexercise of an option would seem to fly in the face of traditional notions surrounding options. Separate charges, thus applied, certainly could make nonexercise of options the more expensive alternative. To that extent, the contract takes on some of the trappings of multiyear procurement.

b. Lease with Option to Purchase

The option can take not only the form of an option to extend a lease but also could be in the form of a lease with option to purchase. With respect to ADPE, GSA has been given wide latitude in determining when such options should be employed.

We are aware of no legal or policy basis for finding unreasonable GSA's insistence on having purchase conversion options in ADP Schedule contracts. Certainly GSA's willingness to accept rental only offers in the past does

not, by itself, preclude a change in policy. In short, we find no basis for concluding that GSA abused its discretion for award of an ADP schedule contract...⁹⁴

Significantly both FPME and DAR set forth a requirement that alternative methods of ADPE acquisition be considered.⁹⁵ Among the alternatives listed is that of lease with option to purchase.

Apparently it is not always clear when a lease with option to purchase (LWOP) is being offered. For example a protest was sustained wherein the solicitation requested offerors to propose plans for purchase, lease, and lease with option to purchase.⁹⁶ IBM, the successful offeror, proposed an alternative purchase plan which it contended was an outright purchase. The protester argued that the proposal was for a LWOP. The proposal provided that after acceptance of the ADPE the agency would acquire most of the rights and obligations of ownership with limited rights to sell, transfer, or encumber the equipment. The plan further required the agency to make monthly payments for 39 months at which time the entire purchase price would be paid and unencumbered ownership would vest in the agency. The obligation to continue payment throughout the 39 month period was, however, subject to the agency's exercise of an option to continue payments at the end of each fiscal year. Failure to exercise this option would result in the ADPE reverting to IBM. Additionally, risk of loss through damage or destruction fell upon the agency throughout the term of these payments. In construing this purchase plan as an LWOP, the Comptroller General noted the following:

[The protester] asserts that the [alternative purchase plan] APP was improperly classified as a purchase plan by GSA and evaluated under the solicitation terms applicable to purchases when, in fact, the APP was a LWOP which should have been considered and rejected pursuant to the solicitation term applicable to rental plans. Thus, the

protester contends that APP conflicts with the following two solicitation provisions which apply to rental but not to purchase plans.

1) Article XVI which provides that the Government shall have the right of discontinuance (right to cancel) without incurring a financial penalty and the contractor shall remove the equipment at its expense

(a) Under the APP the Government is obligated for all payments for each one-year term and must pay the transportation costs for equipment which is returned.

2) Article XVIII (a) and (b), as amended, provides for payment on a monthly basis with invoices to be submitted for the month following use.

(a) The APP provides that at the beginning of each one-year option period the Government is obligated for all payments for that term and monthly invoices are to be paid in advance.

....

However, the APP does not appear to fit within the ... requirements for either a lease or a purchase and its proper designation is at best ambiguous.

The rights and obligations in the equipment conveyed under the APP differ in scope from those an LWOP under the ... provisions normally would convey. For example, it conflicts with ... Article XVI dealing with discontinuance and the cost of returning equipment to the contractor and with ... Article XVIII (a) and (b) regarding payment of invoices in advance of use.

It further differs from an LWOP as it provides that, once it is executed, the agency has "purchased" the equipment and states the agency shall have all rights and obligations of ownership, except that during the term of the APP it may not sell, transfer, ... assign or encumber the equipment. The APP also states that the agency must pay all costs of ownership, including insurance ... Of course, all these elements expire and ownership reverts to IBM if the Government fails to exercise its option to continue the plan at the end of each fiscal year. [But under a LWOP] title and risk of loss shall remain in the contract...⁹⁷

Thus although the Comptroller General stopped short of construing the plan as a LWOP, he did conclude that it was not a purchase and was sufficiently like LWOP to cause the plan to be at material variance with the solicitation. The principal focus seemed to be upon incidence of risks inherent to ownership. LWOP, it appears, would have the contractor retain the trappings of ownership throughout the period of the lease, including risk of loss.

LOWP, then, is merely a specialized kind of option to extend the period of performance. Its use gives the Government added advantages - the ultimate right to acquire outright ownership - over mere option to extend a lease. Also, historically, in the ADPE industry, ownership at the end of a lease of several years can be had relatively inexpensively. This is generally due to rapid improvement in state of the art. Thus through the use of LWOP the Government can acquire ADPE by expending annual funds over the life of the contract. The large financial outlays which generally preclude outright purchase during start-up of ADP systems can be spread out over several years and the ultimate purchase price is greatly reduced. Use of the extension option makes this possible.

Options provide the Government a great deal of flexibility where otherwise the rigidity of fiscal year funding might limit the ability to procure. Nonetheless, as has been shown, options are not properly used in every situation in which the Government seeks to procure beyond its immediate needs. Analytically, the distinction between increased quantity options and options to extend the period of performance is useful to distinguish options from other contract types. But the most significant distinguishing characteristic of all options is that the Government thereby obtains an absolute unilateral right to obtain the optional subject matter.

CHAPTER II - Evaluation

A. Generally

The regulations as well as case law have established the general rule that where options are called for in a solicitation, the optional items will not be evaluated. This rule however is fraught with exceptions, as illustrated by DAR 1-1504.

(a) Except as otherwise provided in this paragraph, solicitations containing option provisions shall state that evaluation will be on the basis of the quantity to be awarded exclusive of the option quantity.

(b) If it is anticipated that the Government may exercise the option at the time of award, the solicitation shall include an Evaluation of Option provision substantially as set for in 7-2003.11(a).

(c) The option quantity may be considered in the evaluation for award of a firm fixed price contract, a fixed price contract with economic price adjustment provisions, or such other types of contracts as may be approved by Departmental procedures, if, before issuance of the solicitation, it has been determined by the Chief of the Purchasing Office that:

(i) There is a known requirement which exceeds the basic quantity to be awarded, but either (A) the basic quantity is a learning or testing quantity and there is some uncertainty as to contractor or equipment performance, or (B) due to the unavailability of funds, the option cannot be exercised at the time of award of the basic quantity; provided that in this latter case there is reasonable certainty that funds will be available thereafter to permit exercise of the option; and

(ii) realistic competition for the option quantity is impractical once the initial contract is awarded and hence it is in the best interests of the Government to evaluate options in order to eliminate the possibility of a "buy-in" (1-311). This determination shall be based on factors such as, but not limited to, substantial start-up or phase-in costs, superior technical ability resulting from performance of the initial contract, and long preproduction lead time for a new producer.

In such cases, the solicitation shall contain an Evaluation of Options provision substantially as set forth in 7-2003.11(b).

(d) The option quantity may be considered in the

evaluation for award of a fixed-price incentive contract if the determination made in 1-1504(c) has been made before issuance of the solicitation, and if the solicitation (i) specifies a cost-sharing arrangement applicable to all proposals, and (ii) specifies that the ceiling price and target profit for the basic and option quantities are to be based on stated percentages of the offeror's target cost. These percentages shall be set forth in the solicitation and shall be applicable to all proposals. In such cases, the Evaluation of Options provisions in 7-2003.11(c) shall be inserted in the solicitation.

Thus the usual rule, as required by the regulations,⁹⁸ is to evaluate the basic contract quantity only.⁹⁹ Optional amounts may be evaluated only if the stated exceptions exist, but then an Evaluation of Options clause is to be inserted in the solicitation.

The philosophical underpinnings of the rule lies in GAO decisions that it is improper to accept a higher bid on the grounds that it will become the low bid upon exercise of an option. This has been viewed as evaluating bids based upon a mere contingency.¹⁰⁰

We think this evaluation was correct. Since the requirements of the Government were uncertain, the invitation specifically provided that the quantity of 30 units was an estimated quantity only and the Government was not obligated to order any units in addition to the 10 units called for by Delivery Order No. 1. We have held it to be improper to accept a high bid upon the basis that it will become the low bid upon the occurrence of a contingency that might or might not arise...¹⁰¹

There is venerable authority for this. A rental-purchase contract was held to have been improperly awarded where the contractor's prices were low overall only if the option to purchase was exercised. Another firm offered lower rental prices but limited to three the number of months' rent which could be applied to the purchase option. In sustaining the protest, the Comptroller General held:

This is no sufficient legal basis for rejection of the low-rental bid meeting the terms of the specifications. Such an argument is based upon a contingency which might or might not arise - that is, conclusion to purchase the calculating machine after 6 months' rental. There appears

no basis for the administrative assumption that conclusion to purchase the machine would be reached after a rental period of 6 months but not prior thereto - it being noted in this connection that not only was the rental cost (without purchase) of the Monroe machine lower than that of the (successful bidder's) Marchant, but the total cost (rental and purchase) of the Monroe would have been lower than that of the Marchant if the purchase had been made after 1, 2, 3, 4, or 5 month's rental...¹⁰²

Thus it has been out of concern for the integrity of the competitive system that GAO maintained rather tenaciously its views that option quantities should not be evaluated. However in 1967 the Comptroller General noted that:

We believe that this rule is in the Government's best interests in the great majority of cases involving options and other contingency factors. However, in recent years we have noted a trend that in addition to the "buy-in" situations you cite, the rule can operate to stifle competition and result in higher long-term costs to the Government ...

In view of the foregoing, we believe that the best interest of the Government may well require the evaluation of options in certain limited situations. However, it must be recognized that the uncertainties inherent in options pose certain dangers to the integrity of competitive procurements. The evaluation of options should take place, therefore, only in exceptional circumstances and under appropriate criteria ...¹⁰³

Thereafter ASPR was amended to permit the cited exceptions under which the Government may evaluate options.

In spite of the well-established strictures against evaluating option quantities absent the stated exceptions, the Comptroller General recently appears to have departed from this hard-and-fast rule. In Safemasters Company, Inc.,¹⁰⁴ GAO upheld evaluation of option quantities stating:

It does not appear that the evaluation or use of the option periods had any effect on the award. Examination of the three bids submitted does not indicate that any of the bidders submitted unbalanced bids, or otherwise attempted to benefit in the event the Government failed to exercise the options ... Additionally Safemasters bid is low whether evaluated on the basic year, the basic year plus the first option year, or the basic year plus both option years ¹⁰⁵

GAO then distinguished the facts in Safemasters from those in Mobilease Corporation¹⁰⁶ wherein evaluation of the option quantity was held to be improper.

In Mobilease, in the view of GAO, since the Government had failed to determine whether a "known requirement" existed for the full option period it was not clear whether award to someone else would result in a lower cost to the Government. But Safemasters was the low bidder under all possible circumstances, thus evaluation of the option and award to Safemasters was allowed to stand. Mobilease's price would have been lower if only the basic year or years 2, 3, or 4 had been included, but evaluation of the full option period displaced Mobilease's otherwise low bid. And this was done without due regard for the regulatory required determinations. Safemasters, therefore, would seem to permit an exception to DAR 1-1504(a) where it is clear that evaluation of optional quantities does not disrupt the competitive process and does not displace an arguably potentially low bidder.

Left unresolved by Safemasters, however, is the situation in which one or more bidders or offerors does submit an unbalanced bid, yet the awardee is still low overall and for each incremental period. Safemasters, on the one hand, would seem to permit award to the overall low bidder in such a case because no other bidder would be prejudiced by such an award. But there is language in Safemasters to indicate that had a contractor argued that its bid was unbalanced (presumably "front-loaded") and would have benefitted in the event that Government failed to exercise the option, award to an overall low bidder would be impermissible. Unbalanced bidding will be examined in detail in Section C (infra).

There has been little litigation involving the exceptions permitting evaluation of optional quantities. However, in Raytheon Company¹⁰⁷ the GAO sustained the Government's not evaluating an option where it did not contemplate exercising the option at time of award and the contract was not fixed-price. Mobilease¹⁰⁸ also addressed the propriety of applying one of the exceptions. There the focus was on whether DAR 1-1504(d) was followed, i.e. was it determined at a level higher than the contracting officer that a known requirement existed for the basic plus option quantity. GAO found that there was no evidence that this determination had been made, nor was there evidence that funds would be available to permit exercise of the options.

Thus it would appear that some evidence must be shown setting forth the fact of the required determinations. And this must be done prior to bid evaluation if option quantities are to be evaluated.

B. Responsiveness

Responsiveness has been a significant issue in cases where the optional quantity is to be evaluated as well as those in which it is not. The general rule that bids must conform to the essential requirements of the IFB or be rejected unless the nonconformity is considered to be immaterial is applicable where the bid is to contain options. Where options are evaluated, omission of a required optional item can compel rejection of the bid as nonresponsive. However rejection is generally not warranted for omission of optional items from bids where options are not evaluated.

1. Responsiveness Where Options Are Evaluated

Where the option quantity is to be evaluated, the responsiveness rules are strictly applied.¹⁰⁹ For example, in Milton Machine Corp.,¹¹⁰ the Government issued an IFB requiring bidders to bid on basic and ten optional quantities. Bidder's omission of the tenth optional incremental quantity in its bid was held to render it nonresponsive. This was true in spite of the fact that the bidder submitted a statement with its bid that the basic quantity price could be used for any option quantity awarded at the time the basic quantity was awarded. The Comptroller General found that since the solicitation contemplated possible option exercise up to 180 days after award, the bid was a material deviation, hence nonresponsive. However, had the entire quantity (basic plus all optional increments) been awarded simultaneously it is not clear that same result would have been reached.¹¹¹ In that instance, the bid would probably have been responsive; the Government could have exercised the options at the basic price.

Compare Comptroller General Decision B-158902, April 18, 1966 (unpublished), in which a bidder submitted a price on the basic work only, pricing the "optional" work at "no cost to owner." Although the CO had rejected that bid as nonresponsive, the Comptroller General held that the bid was indeed responsive. In spite of the solicitation's requirement that "bids must be submitted on all items," it was held that the bidder had merely priced the basic work so as to account for the contingency of the optional work being exercised. This would seem to be irreconcilable with Milton, however it should be noted that this case was more in the nature of additive and deductive items than a true option¹¹² and might be distinguished on that factual basis. Moreover, Milton was nonresponsive because he failed to bid at all on all required items, but the above facts (B-158902) show a bid, albeit "no cost" on all items. Thus responsiveness is established. The Comptroller General stated therein:

This was not a failure to bid which, in the usual case, would require rejection because there would be no assurance that the bidder would be legally bound to perform work covered by bid items as to which no bid price was entered ... Rather, Hunt would have been obligated under his bid to perform under the special conditions at no cost to the Government except with respect to his unit bid prices for drilling ...¹¹³ (emphasis added)

a. Clerical Error Exception

GAO has also used the "clerical error" rationale to avoid the harshness of a finding of nonresponsiveness where a required option price has been omitted. But application of this is limited to well defined facts. For instance where a low bidder submitted a price for a basic quantity, and follow-on quantities 1 thru 5, 6 thru 15, and 26 thru 35

and thereby established a clearly recognizable pattern of prices, the bidder's failure to bid follow-on quantity 16 thru 25 was held to be a correctible clerical error.¹¹⁴

In another case, where the IFB stated "Although award is on an 'All or None' basis bidders must indicate a unit and total price for each item," the Comptroller General found that omission on a single price for an option item was a mere clerical error since a consistent pricing pattern could be shown.¹¹⁵ Therein the Comptroller General held:

In our view, the question for our decision is whether Auburn's bid provides clear evidence of such a pattern of uniform pricing. In each of the decisions cited above in 52 Comp. Gen. 604, supra, and in that decision itself, the bidder was permitted to insert an omitted price where he had bid consistently on the same item elsewhere in the invitation for bids and there was no basis upon which it could be concluded that the bid on the omitted item would be any different. In this case, the prices for items 0001 and 0027 calling for the same work as item 0014 were precisely the same. We believe it is reasonable to conclude that Auburn erroneously omitted a price for item 0014 and the price intended for the omitted item was intended to be the same as that bid in items 0001 and 0027. That this is the case is supported by the other 81 prices inserted in Auburn's bid representing 27 different work items priced for three separate 1-year periods. In all cases, Auburn bid the same price for each of the 1-year periods. Also, award was made on an 'all or none' basis, and a price was omitted for only one of 84 items. Thus we believe the very limited exception to the general rule enunciated in 52 Comp. Gen. 604, supra, may be invoked to permit Auburn to cure the omission. Auburn has submitted documentation to substantiate the existence of its mistake and has expressed its willingness to perform the contract, including the work called for under item 0014, with no increase in total bid. Therefore we believe award should be made at this price if otherwise proper.¹¹⁶

Further delineation of the clerical error exception is found in International Signal.¹¹⁷ There in a 2-step formally advertised procurement, the low bid on Step 2 was rejected as nonresponsive because it did not include bid prices for optional engineering services. The bid failed to include optional "straight-time" hourly rates for Design

Engineering Services and for Field Engineering Services. However the bid did include overtime rates for these services. GAO found that the low bidder, International, did intend to bid the omitted option quantities and that this intent was clearly discernible from the bid documents.

An analysis of the International bid shows that to the extent option items are priced, they are identical in price to each respective basic priced item. For example, with respect to the hardware being purchased (items 1 and 2) and the corresponding option items (11 and 12), the option prices bid were identical to the basic items. (emphasis in original)

In addition, International bid the rate of \$12.50 for weekly overtime hours and \$16.50 per overtime hour for Sunday and Holiday work options (option items 1703 and 1803), which are exactly the rates bid in the basic items (703 and 803). We believe it is not rational to conclude that a bidder would bid on overtime without an intention to perform the basic straight-time work, and that there is an obvious relationship between the basic straight-time and overtime work and the identical work specified as an option. We therefore believe that from the face of the bid a clear pattern of uniform pricing can be established. Thus, in our view, the only reasonable interpretation is that the omitted price for optional straight-time engineering hours for items 13-16 against an overtime rate of \$12.50 per hour is the same as the straight-time rate for items 3-5 against their overtime rate of \$12.50 or \$65.00 per eight hour man-day.¹¹⁸

Thus where there is a clearly defined relationship between the option items bid and other option items for which no prices were bid, correction of the omitted prices will be permitted. But where no such relationship can be established, a bid omitting required option prices is simply nonresponsive and must be rejected as such.¹¹⁹

2. Responsiveness Where Options Are Not Evaluated

In comparison, however, cases in which the optional quantity is not evaluated permit a somewhat looser definition of what constitutes responsiveness. Thus in a case in which the optional quantity was not to be evaluated, a bidder's failure to include option prices did not render

its bid nonresponsive.¹²⁰ This was due in part to evaluation being "exclusive of the option quantity" but also to the fact that the IFB placed no maximum price on option items.

If the IFB specifies that option prices may not exceed the basic bid prices or establishes some other standard for the option price, it is clear that the Government would be deprived of a valuable benefit if it could not exercise an option so limited. Similarly, where the Government intends to exercise the option, or a portion of it, at time of award, a bid without an option price would have to be regarded as nonresponsive.

However when the IFB does not establish a ceiling for option prices and the option prices are not to be included in the evaluation, we do not think that failure of a bidder to quote option prices may be considered to be a material deviation. We see no substantial difference between a bid with an unreasonably high option price and a bid without any option price. Since an otherwise proper bid could not be rejected because of the high option price where the option quantity was not to be included in the award, we see no reason why the absence of any option price should result in rejection. In both cases, the Government's position is basically the same.

We note that the next low bidder in this case quoted identical unit process for both the basic and option quantities. But this fact does not alter our view of the situation. Whether or not the failure to submit option prices is material and constitutes grounds for bid rejection must be determined on the basis of the terms and conditions of the solicitation and not on the basis of option prices quoted in other bids.¹²¹

Compare ITT Federal Laboratories,¹²² in which bids were also to be evaluated "on the basis of basic prices quoted and exclusion of option prices quoted." However there the solicitation stated that the price on the option quantity shall not exceed the basic unit prices. Bidders were required to bid both basic and option items. The contract was awarded to Admiral notwithstanding that its bid on the optional items had higher unit prices than for the basic items. Nonetheless, Admiral's bid was still low overall. In holding that failure to comply with the IFB here did not render Admiral's bid nonresponsive the Comptroller General focused on the competitive impact of the bid.

Furthermore, Admiral does not seem to have gained any material advantage in price, since considering its basic price alone or totaled together with the option price it is still the low bidder and it is not conceivable in these circumstances that any bidder was prejudiced by Admiral's manner of bidding. Therefore, the failure of Admiral to conform to the option price ceiling in its bid does not appear to have been a material deviation, since by the limitation the Government was seeking to obtain the best possible option prices and while Admiral exceeded the limitation it did not prejudice any other bidder ...

Moreover, the evaluation method specified in the invitation for bids provided for evaluation on the basis of basic unit prices alone. Further, there is no intention to exercise the options at time of award. The option prices, while a commitment upon the contractor, do not commit the Government to exercise the options ...¹²³

It is noteworthy that Admiral, after bid opening, agreed to reduce its option price to conform to the IFB. GAO, in this opinion, recommended that award specify that options may be exercised at prices the same as basic unit prices. Although not entirely clear, it is doubtful that the result in the case would have been different absent Admiral's concession. The ratio decidendi would appear to support award to a bidder who, even intentionally, bid higher option prices in the face of contrary instructions. However this would appear true only so long as the overall price was still low.¹²⁴

In ABL General Systems Corporation,¹²⁵ the Comptroller General further explained the Admiral (ITT Federal Labs) decision. In ABL, the IFB called for option prices to be equal to or less than basic item prices and stated that bids would be evaluated "exclusive of the option." ABL's bid, like Admiral's, quoted an option unit price which was greater than the basic unit price. Also like Admiral, ABL's overall price was low. But unlike Admiral, ABL's option price was higher than another bidder's. The contract was, nonetheless, awarded to ABL; the Government reasoned that because ABL was low overall, the Admiral case

permitted award. But this failed to adequately account for the competitive impact of ABL's bid.

For reasons that follow, our position in this area is that where a bidder is low on the base quantity, but higher than the next low bidder on the option quantity, notwithstanding that the bid remains low in the aggregate, such bid is not properly for acceptance under the terms and conditions of the IFB.... (emphasis added)

....

While it is true that ABL is the low bidder on the base quantity, and only the amount bid for the base item is to be used for evaluation purposes, our Office cannot unquestionably conclude that if any other bidder had bid in the same manner as ABL, it would not have displaced ABL as the low bidder. For example, ABL bid \$183.03 per unit on the base quantity and \$292.66 per unit for the option quantity. As contemplated by the IFB, ARA bid \$287.27 per unit for both the base and option quantities. However, if ARA had ignored the price ceiling limitation contained in the option provision and bid in the same manner as ABL, it is quite possible that ARA's base bid could have been reduced below ABL's base bid with the dollars reduction being added to the option price. Since the IFB provides that evaluation is only to be made on the base item price, ARA would then be the apparent low bidder.¹²⁶ (emphasis added)

Thus GAO concluded that the next low bidder had been prejudiced by award to ABL. But this conclusion may be analytically suspect. Prejudice, if indeed there is, lies only in a hypothetical scenario in which the next low bidder completely changes his bid. Apparently no prejudice is found from the simple fact that the next low bidder was low on the option unit prices. Clearly, resort to hypotheticals could have easily resulted in a finding a prejudice in the Admiral case as well. Certainly, hypothetically at least, Admiral's next nearest competitor could have lowered its base bid and raised its option bid much like ARA hypothetically did. Logically, then should there not be prejudice in both cases? The simple answer is: there is. But the ABL case apparently provided a convenient place to "draw the line" at which materially nonresponsive bids are defined. That line, it appears, is

drawn where the IFB calls for a stated maximum option price which is exceeded in the questioned bid and another bidder submits lower option prices. In such a case prejudice will be found notwithstanding that the bid is low overall and low on the base amount. The other bids will be nonresponsive in spite of the fact that option prices are not evaluated.

Cases in which the bidder who prices options in excess of IFB requirements is not low overall are analytically simpler. Such a bid notwithstanding that it is low on the base amount is nonresponsive.¹²⁷ No resort to hypothetical "prejudice" is required. Simply stated, the Government would pay more (if it exercised its options) to the awardee than it would to the next low bidder. Award in such a case disrupts the relative standing of bidders and is therefore prohibited. In such cases, the GAO has found unpersuasive Government arguments that the IFB contained no express requirement to reject bids which did not quote a price for the option quantity equal to or less than the price submitted for the basic quantity or that the option could not be exercised until it was determined to be the best price obtainable¹²⁸ (See Ch III, Sec A). This principle appears to apply to negotiated procurements as well.¹²⁹

In one, albeit unusual, case a bidder's failure to bid on option quantities was upheld by GAO where the solicitation contained the following language¹³⁰

C.83.3 (NOTICE - UNIT PRICES - RANGE QUANTITIES):

Enter unit prices for each specified range for all items for which space has been provided in Section E. DO NOT LEAVE ANY BLANKS. Failure to follow this instruction will render the bid nonresponsive.

D.32 (EVALUATION OF BIDS/OFFERS):

A bidder/offeror must quote on all items in the solicitation to be eligible for award. All items will be awarded only as a unit. Evaluation of bids/offers will be based, among other factors, upon the total price quoted for all items.

C.23 (NOTICE-OPTIONS)

This procurement contains an option provision that allows

unit prices different than those offered for basic contract quantities. The Government may exercise this option at time of award; because of this, the option quantity and price will be an evaluation factor. See Subsection D.24 ...

(D.24) The evaluation of bids will be on the basis of the quantity to be awarded, exclusive of the option quantity ...

The bidder/offeror may indicate in the space provided below, the unit price(s) for the increased quantities if an option is offered.

The solicitation incorporated an Order of Precedence clause which subordinated language contained in the solicitation to that found in the schedule. Subsection D.24 appearing as it did in the schedule thus predominated. Hence the Comptroller General concluded that failure to bid optional quantities did not render the bid nonresponsive; the schedule expressly permitted excluding option prices.

Thus, if a rule can be stated, it appears to be that where options are not to be evaluated, failure to bid option prices will not render the bid nonresponsive. This rule is complicated, however, by cases where notwithstanding that options are not to be evaluated, maximum prices for options are placed in the IFB. In such cases, where bidders ignore the maximum prices limitation, responsiveness issues fall into two general categories. First where the overall bid price including option is low, notwithstanding the bid exceeded maximum option prices, the bid may be responsive. But only if the bid was low on the basic amount and low on all option items. If any option item was not low, then the bid may not be responsive. Second, when the overall bid price including options is not low, the bid is not responsive.

C. Unbalanced Bidding

When the Government evaluates option quantities along with the basic quantities the possibility of receiving unbalanced bids exists.

As a general proposition, unbalanced bidding occurs when

[A] bidder quotes high prices on items which he believes will be required in larger quantities than those used for bid evaluation, and/or low prices on items of which he believes fewer will be called for ...¹³¹

Such bidding is not per se illegal.¹³² But a solicitation which induces unbalanced bidding is defective and should be cancelled.¹³³

1. Mathematically Unbalanced Bids

The initial focus is on the bid itself: Is this bid unbalanced such that some bid items carry only a nominal price while others carry inordinately high prices? Thus the threshold issue becomes the determination of whether or not the bid is mathematically unbalanced.¹³⁴

If each item of the bid carries its proportional share of cost of the work plus profit the bid is not mathematically unbalanced.¹³⁵ No further inquiry into unbalanced bidding is then necessary. But, suppose, for example, the IFB seeks bids for the basic quantity X plus option quantities Y and Z. If a bidder submits a bid of \$500 per unit on X and \$250 per unit on Y and Z (assuming roughly similar costs for X, Y and Z) such a bid is mathematically unbalanced. The bidder is seeking to recoup its expenses early in the procurement cycle or otherwise benefit from such a pricing arrangement. The bidder's expectation is that any losses on the low-bid items would be offset or exceeded by gains on the over-bid items. But simple mathematical unbalancing is not impermissible.¹³⁶

2. Materially Unbalanced Bids

A mathematically unbalanced bid, however, is not appropriate for award if it is materially unbalanced. This second level of inquiry to determine if a bid is materially unbalanced focuses not upon the bid, but upon the solicitation and the cost impact of the bid.¹³⁷

Our Office distinguishes between mathematical and material unbalancing. Mathematical unbalancing relates to whether each bid item carries its share of the cost of the work plus profit or whether the bid is based on nominal prices for some work and enhanced prices for other work. Material unbalancing relates to the cost impact of a mathematically unbalanced bid. 'Unless there is reasonable doubt that by making award to a party submitting a mathematically unbalanced bid, award will not result in the lowest ultimate cost to the Government, the bid should not be considered materially unbalanced' Mobilease Corporation, 54 Comp. Gen. 242, 245 (1974) 74-2 CPD 185.¹³⁸

To ascertain whether or not a bid is materially unbalanced, it must be determined whether or not award was made to other than the low bidder. Theoretically this should be an easy task. Simple comparison of the bids themselves should reveal the relative standing of the bidders. But where a solicitation sets forth estimated Government needs such comparisons become problematical.

We believe that, as a general rule, the inquiry into material unbalancing begins with an examination of the solicitation and its evaluation formula, the determination that a mathematically unbalanced bid has been submitted has the effect of calling into question the accuracy of the solicitations estimate of the anticipated quantity of work and, thus, the evaluation basis upon which bids or offers are being considered for award. If, after examination, the contracting agency believes that the solicitation's estimate is a reasonably accurate representation of actual anticipated needs, then the mathematically unbalanced low bid may be accepted ...¹³⁹

If there is doubt concerning the accuracy of the Government's estimated needs set forth in the IFB, such doubt may be resolved against award to the mathematically unbalanced bidder.¹⁴⁰ Thus where a

protesting bidder shows evidence that Government estimates of work were inaccurate, the Government must then show evidence that its estimates were indeed accurate. Failure to do so can result in a finding that a mathematically unbalanced bid was in fact materially unbalanced.

If the solicitation's quantity estimates are not reasonably accurate, there is reasonable doubt that award to any bidder would result in the lowest ultimate cost to the Government; the proper course of action in such circumstances is to cancel the IFB and resolicit ...¹⁴¹

It appears, therefore, that where there is a mathematically unbalanced bid coupled with an erroneous estimate of work there is a presumption of sorts that award is to other than the low bidder. Thus the cases speak in terms of materially unbalanced bid simply upon a showing of erroneous solicitation.¹⁴²

However the second and perhaps more significant analytical element is the cost impact of the mathematically unbalanced bid. A factual showing even in the face of an erroneous estimate of work, that the unbalanced bid will result in the lowest cost to the Government will permit award to be upheld.

Comp. Gen. Dec. B-161208 illustrates this.¹⁴³ In that case GSA advertised for repair and installation of rugs. The IFB provided that award was to be made in the aggregate for all services in each geographic area, and that the low aggregate bid for each area would be the sum of the items determined by multiplying the item unit price by the stated weight factor for such item. Included in the weight factors were certain optional items such measuring services. In denying a protest which was based, inter alia, on an allegation that erroneous weight factors gave rise to materially unbalanced bidding GAO held:

We seriously question the wisdom, under these circumstances, of cancelling the Invitation for Bids as to

service area 2. While as a technical matter the weights used were inaccurate, this apparently had no effect on the bid evaluation and we have no doubt that an award made to Arlington would result in the lower overall cost to the Government.

....

Although the erroneous weight factors were not completely corrected in the second invitation, the administrative report indicates that the award made to Ray's Carpet and proposed award to Arlington will result in the lowest overall cost to the Government when evaluated on the basis of the revised [albeit erroneous] weight factors. That being the case, we would not be justified in objecting to the award or to the proposed award.¹⁴⁴ (emphasis added)

The burden of demonstrating that a mathematically unbalanced bid, when applied to erroneously weighted evaluation factors, is the low overall bid is admittedly substantial. Nonetheless, where the Government can make such a demonstration bids of that nature will apparently be upheld.

Mobilease Corp.¹⁴⁵ involved a somewhat different twist to the puzzle of unbalanced bidding. There bidders were warned in the IFB that materially unbalanced bids may be rejected as nonresponsive but nowhere did the IFB set forth what constituted a materially unbalanced bid. The Comptroller General was critical of this procedure. After discussing the basic test to determine mathematically and materially unbalanced bids he stated:

In this regard, no criteria were expressed in section "D" [of the IFB] to aid in a determination of the "materially unbalanced" bid. Any determination under this section would necessarily be subjective in nature without reference to standards or common guidelines. Certainly faced with this provision, bidders were unable to prepare their bids with any assurance that their bids would not be rejected because of unbalancing. We recommend that the language of section "D" be critically examined to determine its utility in evaluating bids under an IFB such as involved here. In this kind of situation both guidelines should be provided as to what constitutes an unacceptable unbalanced bid. It might have been preferable here to have advised bidders that option prices should be the same for

all option periods ...¹⁴⁶ (emphasis added)

Thus while GAO took issue with the Government's method of attempting to control unbalanced bidding, it pointed out an acceptable procedure for doing so. Level bidding apparently is one such acceptable method. Discount to present value is another possible approach to reducing the anti-competitive effects of unbalanced bidding. Both will be examined in detail in infra.

3. "Buy-in"

A type of unbalanced bidding which may occur when option prices are not evaluated is the "buy-in." "Buy-in" is generally defined as a below-cost bid for the basic items coupled with prices for optional items established sufficiently high to more than offset the initial loss position. Although there is no prohibition against the practice,¹⁴⁷ various procuring agencies have promulgated regulations designed to control use of "buy-in" as a bid technique.¹⁴⁸ For example DAR 1-311(b)(ii) suggests the use of priced options to as great an extent as practicable. However, as already noted, option prices are not generally evaluated. Nonetheless where the Chief of the Procuring Office determines that realistic competition for the option quantity is impracticable after award of the basic contract and evaluation of option quantities is in the Government's best interests to avoid a "buy-in", an exception is permitted under DAR 1-1504(c)(ii). This would seem to require a certain amount of clairvoyance on the Government's part, but this provision does appear to provide some measure of control in the situation where a bidder or offeror is willing to absorb high start up costs, thus offering low prices on the basic contract with the

expectation that because of its technological or industrial superiority it will become sole source with high priced option years.¹⁴⁹

A bid cannot be rejected on the sole ground that it is unreasonably low.¹⁵⁰ In a case in which the Air Force included a "Reasonable Costs/Minimum Manning" provision in an IFB for a janitorial services contract, the GAO held that this in effect converted responsiveness to responsibility.¹⁵¹ And although DAR 2-403.2(e) permits rejection of unreasonably priced bids, this applies only to unreasonably high priced bids.

In our view, the subject IFB is materially deficient because section D-3 requires that noncompliance with this clause will result in a bid being rejected as nonresponsive. In our opinion, the Air Force has improperly converted a matter of responsibility into a matter of responsiveness ... Further, the section's specified authority to reject bids as nonresponsive is not authority to reject an unreasonable low bid. DAR §2-404.2(e) (1976 ed.), which provides that a bid may be rejected if it is unreasonable as to price, applies only to reject for the benefit of the Government excessively high bids ...

Moreover, the regulations provide measures to be taken if a bid is suspected of being too low. For example, the contracting officer should request verification as required by the mistake in bid procedures set forth in DAR §2-406 (1976 ed.). Further, DAR §1-311 (1976 ed.), dealing with the practice of "buying-in", does not permit the contracting officer to reject as nonresponsive a bid suspected of being below cost. Rather, postaward and follow-on procurement safeguards are required to protect the Government.¹⁵²

Thus a bidder or offeror is free to bid below cost on the basic contract with the expectation that it will receive the optional work at prices which offset initial losses. The requirement to "test the market" prior to exercise of options¹⁵³ theoretically ameliorates the impact of this practice to a great degree.¹⁵⁴ Furthermore, GAO has taken the position, at least with respect to service contracts, that a bid below cost requires that the CO review the bidder's responsibility before

award.¹⁵⁵ Clearly a loss position would affect a firm's ability or willingness to perform work, hence such inquiry is reasonable. Nonetheless a requirement to determine that a bidder is responsible adds nothing to the CO's pre-award duties.

Establishing "buy-in" can require more than a mere showing that the bid or offer was below cost. In the view of the ASBCA, at least, the Government must also show that such a bid was made with the specific intent to recover contemplated losses through favorably priced change orders or through enhanced pricing of "follow-on" contracts.¹⁵⁶

Looking at the ASPR definition of a "buy-in" [§1-311], it is seen to contemplate a loss position on a particular contract where that loss position was created with a specific described intent. The intent may take one of two forms: either 1) accomplishment of an increase in the contract price by change orders or other means, or 2) setting high prices for follow-on contracts to cover the original "buy-in" losses. We find the Government has not met the tests of a "buy-in" as laid down in this regulation. It has not been established to our satisfaction that the fixed price offered in the second step of this two-step procurement was 'a price less than anticipated costs' with the expectation of accomplishing recoupment through either of the two methods mentioned in the regulation.¹⁵⁷ (emphasis added)

The Government's "buy-in" argument, arising as it did over a dispute before the ASBCA surrounding the pricing of options appears to be uniquely raised in this case. Subsequent ASBCA cases dealing with similar facts have decided the issue on retrospective price computation¹⁵⁸ or weighted guideline method of profit negotiation.¹⁵⁹ Hence applicability of the "specific intent" rule is of questionable importance. And although this would seem to significantly add to the Government's burden, since "buying-in" is not prohibited under DAR 1-311, this additional requirement has little practical efficacy.

The better reasoned view appears to be that propounded by GAO:

ASPR 1-311 addresses the situation where an offeror knowingly offers a price substantially below anticipated cost with the expectation of recovering the loss by an increase in price through change orders during performance or by receiving follow-on contracts at prices high enough to recover the loss on the original 'buy-in.' The act of willfully bidding below cost is not expressly prohibited. However, when there is reason to believe that this has occurred, the contracting officer is required by that regulation to assure that the difference is not recovered in the pricing of change orders or of follow-on procurements subject to cost analyses. Further, since the regulation does not provide for rejection of a bid where 'buy-in' is suspected, we have recognized that there is no legal basis upon which an award may be precluded or disturbed merely because a low bidder submitted an unprofitable price....¹⁶⁰

Moreover, we have held that the fact that a low bidder may incur a loss at its bid price does not justify rejection an otherwise acceptable bid ... To properly reject a bid as being extremely low would require a determination that the bidder was nonresponsible ... it should be noted that our Office does not review protests against affirmative determinations of responsibility ...

The rule that GAO will not review affirmative determinations of responsibility is therefore applicable to the "buy-in."¹⁶¹ This was clearly set forth in Allied Technology, Inc.,¹⁶² where the protest alleged, inter alia, that a bid was so low as to preclude profit or recovery of overhead costs and was so low as to evidence a clear lack of understanding of the effort involved in performing the contract. In denying the protest the Comptroller General stated:

Even if Allied's contentions concerning cost are correct, ASPR §1-311 (1975 ed.) does not preclude acceptance of below cost bids, but mainly cautions contracting officers to assure that amounts excluded in the "buying-in" contract are not recouped through change orders or follow-on contracts. Since the regulation does not provide for rejection where "buying-in" is suspected, our Office has repeatedly held that award may not be withheld or disturbed merely because the low bid is below cost.... The Navy was convinced that Esterline fully understood the Government's requirements, and that it would comply with the specifications. This office has held that so long as the bid of the suspected "buying-in" is low and is responsive to the invitation requirements, and the bidder is determined to be responsible, award must be made to that

bidder ... To the extent that Allied contests the affirmative determination of Esterline's responsibility, such contention will not be considered ...¹⁶³ (emphasis added)

This rule applies with equal force to negotiated procurements.¹⁶⁴

However where an RFP contained the following clause:

D.37 COST REALISM IN REQUEST FOR PROPOSALS
(1974 NOV)

An offeror's proposal is presumed to represent his best efforts to respond to the solicitation. Any inconsistency, whether real or apparent, between promised performance and cost or price, should be explained in the proposal. For example, if the intended use of new and innovative production techniques is the basis for an abnormally low estimate, the nature of these techniques and their impact on cost or price should be explained; or, if a corporate policy decision has been made to absorb a portion of the estimated cost, that should be stated in the proposal. Any significant inconsistency, if unexplained, raises a fundamental issue of the offeror's understanding of the nature and scope of the work required and of his financial ability to perform the contract and may be grounds for rejection of the proposal. The burden of proof of cost credibility rests with the offeror. (emphasis added)

The Comptroller General stated that although this language would appear only to give the Government an option to reject an allegedly below-cost, "unrealistic", offer, such rejection, albeit discretionary with the CO, would arguably contravene previous GAO decisions.¹⁶⁵

This clause has two significant aspects. First, it appears to delineate specific responsibility criteria. The Comptroller General has allowed nonresponsibility determinations to be made where a bidder or offeror fails to meet stated responsibility criteria.¹⁶⁶ Thus the clause would seem to permit a finding of nonresponsibility where the price submitted was unrealistically low, and the offeror does not explain the apparent price disparity to the CO's satisfaction. By itself such a provision would not seem objectionable. However the second aspect of the clause is that it is akin to a minimum price clause. This has been found

objectionable in advertised procurements for service contracts¹⁶⁷ and would seem no less objectionable in negotiated procurements.

GAO has indeed upheld a finding of nonresponsibility based upon a below cost bid.¹⁶⁸ And, although "buy-in" is not directly discussed, the case is nonetheless instructive. The facts were that the low bidder, DCA/Massa, had been awarded a previous supply contract for similar items four years earlier. Massa's per unit cost was about \$61,000. Under the instant IFB, Massa was low bidder for the same items bidding about \$35,400 per unit. The CO determined that Massa was not responsible and awarded the contract to the next low bidder. The CO cited both the fact that performance at the bid price would generate a loss of \$700,000 for Massa and that DCA, Massa's parent company, had filed for bankruptcy. The Comptroller General, in upholding the CO's action, noted that although the parent company's bankruptcy does not mandate a finding of nonresponsibility, it permits it. Further, that the loss posture into which Massa was interjecting itself by below-cost bidding raised doubts that it had sufficient financial capability to successfully perform the contract.

[W]e believe that a reading of the entire record supports the administrative determination that DCA/Massa does not possess a strong financial capability and it is at least doubtful whether Massa could successfully perform a multi-year contract of the amount involved here ...¹⁶⁹

Thus absent some basis for finding of nonresponsibility, a "buy-in" bid should not be rejected simply because of its below-cost nature.

"Buy-in" may be a disfavored practice but it is permissible.

4. Attempt to Control Unbalanced Bidding and "Buying-in"

Unbalanced bidding and its corollary, "buying-in" both arguably tend

to skew the evaluation process thereby making it more difficult to foster full and free competition. Thus there have been efforts to eliminate or minimize their use in the procurement process.

One noteworthy legislative venture in this regard was embodied in H.R. 4717, 96th Cong., 2nd Sess. This piece of legislation was an effort to amend Title 5, U.S.C. respecting personnel ceilings within Federal Civil Service. The thrust of the legislation was aimed at controlling certain "contracting out" practices as promulgated under OMB Circular A-76. Among the measures put forth was proposed Section 3703(b) which addressed "buy-in". Specifically aimed at service contracts, it would have required cost comparisons prior to renewal of these contracts and contained formulae setting out what constituted a "significant increase" in cost justifying non-renewal. Contract renewal, as used therein included inter alia prepriced renewals as well as renewal options provided for under the terms of the original contract.¹⁷⁰ Of particular interest here is the approach taken by this legislation in determining whether a "significant increase" in expenditures would occur by exercise of the option. The formula employed under §3703(b)(2) required that the agency develop the following information:

2. The average annual rate of expenditures incurred by the United States during the most recent three years under the original contract (or over the period the contract was in effect, if less than three years) ...

3. The GNP deflator for the calendar quarter in which the original cost comparison was conducted ...

4. The average rate of change in the GNP deflator for the four most recent calendar quarters ...

5. The estimated GNP deflator for the calendar quarter occurring immediately before the end of the 12-month renewal period based on the average rate of change in the GNP deflator for the 4 most recent calendar quarters ...

6. The percentage by which the estimated GNP deflator for the calendar quarter occurring immediately before the end of the 12-months renewal period ... exceeds the GNP deflator for the calendar quarter in which the cost

comparison was conducted ...

7. The average annual rate of expenditures incurred by the United States under the prior contract ... adjusted by the percentage increase in the GNP deflator ... (If the renewal cost exceeds this figure by more than 2% a new cost comparison under OMB Circular A-76, Section 9, is not required).¹⁷¹

This convoluted series of calculations would have established merely the requirement for a new cost comparison before an option could be exercised. Although this would indeed regulate, to a large extent, "buy-in" practices, it is really little more than formalized market testing prior to exercise where the contract renewal takes the form of an option. This practice is currently required, although with significantly less formality under the procurement regulations¹⁷² and would seem to be a satisfactory solution to the "buy-in" problem.

a. Level Bidding

Level bidding, perhaps a more practical approach to protecting the Government against "buy-in", establishes a maximum above which options may not be priced. The concept has previously been mentioned concerning the effect of noncompliance with a solicitation's limits upon option prices as it effects responsiveness. Now the focus is on the effect level bidding has in insuring the Government gets the best price possible for basic as well as option quantities.

ABL General Systems Corporation¹⁷³ of importance on the issue of responsiveness, is also a useful case to begin a discussion of the price consequences of level bidding. The GAO therein expressed concern that level bidding would cause "front-loading", hence artificially price certain contingencies into the basic contract.

Additionally, our office is concerned with the use of an option provision like the one contained in section "J"

of the IFB. A clause of this nature appears to cause a "frontloading" of costs on the base quantity which are transferred from the option quantity to equalize the prices bid, when in actuality there is no assurance that the option will even be exercised. What this does, in effect, is cause the Government to pay for a portion of an optional item each time a base item is paid for. If the option is not exercised the Government will pay a price in excess of the reasonable competitive value of the item delivered ... Therefore, we recommend that the language of section "J" be critically examined with the view of devising an option provision which will eliminate the above-mentioned deficiencies in future procurements of this nature.¹⁷⁴

Thereafter, in Keco Industries, Inc.,¹⁷⁵ the Comptroller General noted with approval DAR (then ASPR) 7-104.47 (1974 ed.) as clearly setting forth the bidder's obligations as well as clearly explaining how the Government intends to construe the option provision in a multi-year procurement. However, the Keco decision further admonished the Government to devise option clauses to prevent "front loading".

We note in ABL General Systems Corporation, supra, that this type of option provision may cause a bidder to include a contingency in the bid to cover the possibility that the option may be exercised at the time when costs might exceed the unit price. If the option is not then exercised, the Government may be paying a price in excess of that which reasonable competition would have brought. We suggest that the language of these clauses be reviewed to devise an option provision which will eliminate this problem. A revised option provision and guidelines for its use were developed and transmitted to the ASPR Committee for consideration as a result of our recommendation in ABL General Systems, Corporation, supra.¹⁷⁶

Subsequent to Keco, DAR was changed to reflect this policy. Hence

DAR 1-1502(d) states:

Solicitations normally should allow option quantities to be offered without limitation as to price, and there shall be no limitation as to price if the option quantity is to be considered in the evaluation for award pursuant to 1-1504. In unusual circumstances, solicitations may require that option quantities be offered at prices no higher than those for the initial quantities. Such circumstances may exist, for example, where (i) the option cannot be evaluated pursuant to 1-1504(c) or (d) because additional requirements are foreseeable but not known, and (ii)

realistic competition for the option quantity is impractical once the initial contract is awarded. However, because such limitations as to option prices tend to cause a "frontloading" of costs on the basic quantity which are transferred from the option quantity to equalize the prices offered, their improper inclusion could result in prices which are unfair to the Government should the options not be exercised. Therefore the procedures in 1-1503(d) shall be followed. (emphasis added)

DAR 1-1503(d) requires, where option prices are limited per 1-1502(d), that:

(i) the inclusion of such limitation as to option price shall be justified and documented by the contracting officer in the contract file;

(ii) the solicitation shall also include a conspicuous notice adjacent to such limitation as to option price cautioning offerors that an offer containing an option price higher than the basic price may be accepted only if such acceptance does not prejudice any other offer;

Level bidding is then, the exception rather than the rule. The CO must document his reasons justifying inclusion of a level bidding provision in any contract. It would seem that the concerns which initially gave rise to level bidding could easily give way to greater problems caused by its overuse. Clearly "frontloading" is a valid issue anytime level bidding is mandated. The Government can not be certain that it indeed receives the lowest price in any such procurement. On the other hand, a "buy-in" virtually assures the lowest price for the basic quantity. It is only if the Government, after creating essentially a sole source situation, exercises an option that "buy-in" becomes more costly. It is a matter of conjecture, but it appears that the cure may be more troublesome than the illness in this instance.

b. Present Value of Money

Much as level bidding seeks to offset the arguably anti-competitive effect of "buy-in", discount to present value (PV) is a technique which

is being used, at least to a limited extent, to counteract unbalanced bidding. The evil sought to be eradicated arises when a mathematically unbalanced bid is apparently low overall. Generally this results in award to that bidder. But award results in inordinately high expenditures in the initial year and less in option years. The contractor obtains use of money, a valuable right which, unless PV was computed in the evaluation, was not considered in establishing "low overall" bid.

OMB Circular A-94¹⁷⁷ would seem to mandate that executive agencies apply discounting principles in evaluating measurable costs or benefits of programs or projects where they are distributed over time. Paragraph 3 thereof entitled "Scope" reads as follows:

a. This Circular applies to all agencies of the executive branch of the Federal Government except the U.S. Postal Service. The discount rate prescribed in this Circular applies to the evaluation of Government decisions concerning the initiation, renewal or expansion of all programs or projects, other than those specifically exempted below, for which the adoption is expected to commit the Government to a series of measureable costs extending over three or more years or which result in a series of benefits that extend three or more years beyond the inception date ...¹⁷⁸

Specifically exempted are acquisition of "commerical-type services" by the Government under OMB Circular A-76¹⁷⁹ as well as selection of automatic data processing equipment.¹⁸⁰

Thus, it would appear that options which cause a contract to potentially run for three or more years must include a PV evaluation factor. Nonetheless DAR does not presently contain a clause which embodies this mandate. The FPMR, on the other hand, does address the question of PV analysis.

Evaluation of acquisition alternatives.

(a) Comparable cost analyses shall be made to determine the

method of acquisition that represents the lowest overall cost over the system/item(s) life. The alternatives that must be considered will vary depending on the system/item being acquired and the requirement of the initial user. However, as a minimum, all of the alternatives set forth below, which will meet the user's needs, shall be considered ...

(iii) Lease with option to purchase

(b) The present value of money factor, as set forth in OMB Circular A-94, shall be included in comparative cost analyses. The single discount rate (currently 10 percent) specified in the OMB Circular represents the approximate longrun opportunity cost of capital in the private sector. Under this methodology, payments over time are adjusted to reflect the present value of these payments as of the date of contract award. All expenses over the systems/item(s) life for equipment, software, maintenance, other support, and predetermined in-house expenses for installation and operation must be adjusted.¹⁸¹

Thus the FPMR requires that PV of money be considered when evaluating ADPE lease options. Such a requirement should also appear in DAR and other agency regulations where option prices are to be evaluated and the contract could extend over three years.

There have been few cases addressing the application of PV principles in the evaluation of options. One such case involved a protest which questioned the application of PV analysis to a prompt payment discount otherwise applicable.¹⁸² The RFP contained the following clause:

PRESENT VALUE METHOD"

A present value method will be used in calculation of all costs. The discount rate will be applied annually. The rate used will be the current average market yield, rounded to the nearest one-eighth of one percent, on outstanding treasury marketable obligations with approximately five years remaining to maturity at the time proposals are received. As an example, if the rate were 6%, the factors would be:

<u>Year from contract award</u>	<u>Discount Factor</u>	
1	.943	
2	.890	
3	.840	
4	.792	
5	.747	183

There GAO held that it was not objectionable to apply PV of money to

the prompt payment discount.

In regard to Linolex's allegation, we see nothing wrong with not applying the PVM to a prompt payment discount. Since the amount the Government will be paying out is the amount of the monthly invoice minus the 3 percent discount, only the total should be discounted by the PVM because that is the amount the Government is actually spending.¹⁸⁴

Although the opinion noted that the reason for PV analysis is to aid in making a decision whether to lease or purchase equipment, it would seem to have equal applicability in comparing basic and option prices of various offerors. In that regard the Comptroller General noted:

The reason for the use of the PVM is that in making the determination whether to lease or purchase equipment, the time value of money must be considered. It is necessary to determine present values because money has earning power over time. A dollar received today is worth more than a dollar received next year and, conversely, to postpone spending a dollar until next year gives one the opportunity to earn interest on that dollar or otherwise productively use it for the one-year period.¹⁸⁵

That the PV method is mandated for use beyond merely deciding as between purchase and lease was clearly announced in a recent Comptroller General opinion.¹⁸⁶ In this case the Air Force argued that it had received a waiver from GSA permitting exclusion of PV discounting in the evaluation of proposals. Further and more significantly that because it had used PV discounting in making the pre-solicitation comparative cost analysis to determine what form of acquisition to use, the FPMR requirements were met. GAO disagreed.

[U]nder FPMR ... there was a requirement to take into account the present value of money in the evaluation of proposals received as well as the early stages of the procurement before the request for proposals was issued. The Air Force's argument that it fulfilled the requirement ignores the fact that the major purpose of the regulation was to assure that the Government received the "lowest overall cost." This objective could not be attained by merely comparing alternative methods of acquisition before issuing the request for proposals without comparing

alternative approaches actually received in response to the request for proposals.¹⁸⁷ (emphasis added)

However, GAO did conclude that the Air Force acted reasonably by relying on GSA's representations that the PV discount language was not required to be included in the solicitation.

FPR §1-4.1110-3 illustrates a current required option clause relevant to ADPE acquisition. When this fixed price option clause is used the solicitation must also specify the present value discount methodology, including payment schedule, that will be used for evaluation. The clause reads as follows (in relevant part):

FIXED PRICE OPTIONS PROVISION

....

(2) Evaluation of Prices. Offers will be evaluated for purposes of award by adding the total price of all optional periods [and stated optional quantities]* to the total price for the initial contract period covering the initial system or items. These prices will be adjusted by the appropriate discount factors shown in *** of the solicitation document. Evaluation of option prices will not obligate the Government to exercise the options ... Offers which meet the mandatory requirements will be evaluated on the basis of lowest overall cost to the Government, price and other factors considered. (emphasis added)

*Delete when inapplicable

*** Insert location in the solicitation where appropriate discount factors and the contemplated payment schedule are specified

An illustration of the use of PV analysis in life cycle cost evaluation where options are incorporated in a solicitation is contained in Appendix A. Thus, ADPE procurements which include option provisions must include a PV evaluation. This is expressly done because option prices are evaluated at the time of initial award to avoid a "buy-in." Unbalanced bidding with front-loaded bids would be the probable result unless this approach were taken.

It would seem no less true that PV analysis should be employed in other procurements where options are evaluated at time of award, but exercise of options is to occur sometime after award. Nonetheless, the regulations do not currently reflect this policy. Bidders are free therefore to bid mathematically unbalanced bids (but not materially unbalanced ones) under the fiction that the Government's interests are served as long as it can show that award was made to the numerically low bid. Continued failure to account for the value of money over time is a costly procurement practice which ought to be revised.

The process of evaluation is made more complicated where options are solicited. Initially the CO must determine whether or not a basis exists for evaluating options at all. The regulations provide guidance here, but the CO's judgment regarding the potential for a "buy-in" also comes into play. In any event, whether options are evaluated or not, their inclusion in a solicitation can seriously disrupt the orderly process of determining low bid or best price if not carefully examined. Close analysis where unbalancing occurs is critical if the Government's best interests are to be served and competitive integrity is to be maintained.

CHAPTER III - Exercise

The exercise of Government contract options, like the exercise of options in non-Government contracts, must conform to rules respecting timeliness and format. But before a Government contract option can be exercised the market must be tested. This means that the CO must determine that the option price is the best price available or exercise of the option is otherwise in the best interest of the Government. In this regard the rules for exercise of Government contract options departs significantly from similar rules in other kinds of contracts. These concepts are examined in detail in this chapter.

Also considered herein are "exercise" rules pertaining to indefinite quantity contracts and unpriced options. Indefinite quantity contracts are rather clearly distinguishable from options. Thus "exercise" is a considerably different undertaking than the exercise of an option. Likewise, the exercise of unpriced or "soft" options departs from the traditional notions attending the rules of exercise. In fact, as is discussed herein, these may not be options at all, but simply agreements to negotiate for certain optional items. Thus this chapter entitled "Exercise" concludes with two sections that, perhaps, do not deal with exercise of options at all.

A. Requirement to "Test the Market"

DAR 1-1505(c)(iii) prescribes that options should be exercised only if it is determined that exercise is the most advantageous method of fulfilling the Government's needs, price and other factors considered.¹⁸⁸ This has generally meant that the Government must "test the market" to some degree before exercise of an option is proper.

1. The Degree Required

A new solicitation is appropriate unless the contracting officer anticipates that the option price will be the best price available.¹⁸⁹ In that case, DAR provides for less formalized procedures for testing the market.¹⁹⁰ However, where a contracting officer readvertised rather than exercise an existing option for test equipment under a firm fixed price contract, his decision was upheld over the protest of the optionee whose unit prices were higher than the successful bidder.¹⁹¹ The GAO has held that a determination by the contracting officer to invite new bids rather than exercise an option is not subject to legal review. Options are for the benefit of the Government and a contracting officer's determination that exercise may not be in the Government's best interests is not subject to legal review by the Comptroller General or by the Courts.¹⁹²

An option is a privilege given by the owner of property to another to buy the property at his election. It secures the privilege to buy and is not of itself a purchase. The owner does not sell his property; he gives to another the right to buy at his election¹⁹³ (emphasis in original)

Thus, where the contracting officer makes an affirmative decision to test the market and not exercise an option, his actions will not be reviewed.¹⁹⁴

Conversely, a contracting officer's determination to exercise an option is subject to review where a protester alleges exercise is contrary to applicable regulatory provisions.¹⁹⁵ Although the exercise of an option is in the nature of contract administration, the Comptroller General has held that :

[since] the contracting officer's administrative authority is subordinate to the competition statute, it follows that due regard for protection of the integrity of the competitive procurement system does not interfere with the legitimate exercise of the contracting officer's administrative functions¹⁹⁶ (emphasis in original)

Even where there are no regulatory provisions governing exercise of options¹⁹⁷ the Comptroller General has held that where the option price was not evaluated in making the initial award but was only added as a subsequent modification of the contract the procedure followed in exercising the option should comport as much as possible with the competitive norm of federal procurement.¹⁹⁸ Thus where the Government sought to exercise an option to purchase additional electronic data processing equipment, the GAO took the view that the actions taken by the Government in exercising the option were reviewable.¹⁹⁹

Although bids solicited "solely for the purpose of determining whether an available option price can be bettered" have been criticized,²⁰⁰ this procedure may be the only means of effectively testing the market.²⁰¹ The Comptroller General appears to take the position that existing DAR procedures satisfy the requirement of competition, although this permits an "informal" determination by the contracting officer that a better price can not be obtained.²⁰²

A contracting officer's determination to exercise an option without soliciting bids has been upheld where a protester had successfully protested earlier option exercises and then failed to bid on the

resulting solicitations.²⁰³ In that case there were only two potentially interested parties and the protesting party had historically declined to bid on similar contracts. The contracting officer there appeared to conduct the requisite degree of market test, albeit informally.

The Government's exercise of an option was similarly upheld where options were available under two different contracts and the agency concluded that only the higher priced option could meet its needs.²⁰⁴

The Comptroller General in upholding the agency's exercise stated:

While there is no regulatory provision that deals explicitly with this situation, the provisions of DAR §1-1505 do call for the agency to make a judgment as to whether the exercise of a particular option is the most advantageous method of fulfilling the Government's needs, price and other factors considered.... Here the agency compared the prices and existing delivery schedules ... and determined that although Bristol offered the lowest price it could not meet the delivery requirements²⁰⁵

Although the Comptroller General acknowledged the propriety of not soliciting bids because of an urgent requirement, he appeared to approve of a comparison of the two options in lieu thereof. He nonetheless permitted exercise of the higher priced one.

Testing the market has also been held to be adequately done where the contracting officer informally found that required items could not be furnished by the protesting bidder in a timely manner because "first article testing" would be required of all but the incumbent contractor.²⁰⁶ In that case the Comptroller General distinguished

"award" from exercise of an option:

At the outset it should be pointed out that the 'award' against which you protest was not an award of a contract incident to a new solicitation but rather represented the exercise of an option under an existing contract...²⁰⁷

He then concluded that the contracting officer had complied with DAR

(then ASPR) 1-1505 by inquiring of the protester what prices it could offer if the procurement were competed both on a first article test and waiver of first article test basis.²⁰⁸

"Price samplings" taken from local advertisements have similarly withstood GAO scrutiny.

We do not believe that the contracting officer's determination must be based on such overwhelming evidence as to render a contrary determination unsupportable, we think it is sufficient if his determination is made in good faith and supported by substantial evidence. We find these criteria are satisfied in this case.²⁰⁹ (emphasis added)

A contracting officer's informal market determination was similarly found to be supported by substantial evidence where he made a "projection" of market prices based on existing information.²¹⁰

Thus the degree of market test required does not appear to be substantial. Nonetheless the CO must undertake some inquiry, even if informal, before proceeding. In cases in which market prices are obvious to the CO, his determination that the option price is the best price will be permitted.

2. The Incumbent Contractor

An incumbent contractor finds itself in a rather unusual position because of the requirement to test the market. The market test may involve soliciting bids against revealed option prices. The Comptroller General has held this procedure is acceptable, notwithstanding the disadvantage which this places the incumbent contractor.²¹¹ The option price becomes a matter of public record when it is a part of an advertised bid. Furthermore the incumbent contractor itself may compete against its own option prices.²¹²

Testing the market may result in non-exercise of an option for

reasons not clearly ascribable to price alone. Hence, the contracting officer may properly award to a competing firm rather than exercise an option where a second source of supply was considered to be in the Government's best interests.

Neither can we agree with your contention that the establishment of a second source was an extraneous consideration in this procurement. The S-GC bid was being compared to a contract option. Such comparison is not the equivalent of evaluating two bids under the same invitation. ASPR 1-1505(c) provides, as noted, that an option should be exercised only if it is determined that such action is '... most advantageous to the Government, price and other factors considered.' ASPR 1-1505(e) explains that 'other factors' include the Government's need for continuity of operations and potential costs to the Government of disrupting operations, including the cost of relocating necessary Government furnished equipment. While the aforementioned factors weigh in favor of exercising the contract option, factors which favor the acceptance of a competing offer, i.e. the establishment of a second source, by implication should also be considered.²¹³

On the other hand, the incumbent contractor's position is enhanced simply because there is continuity of supply or service. This advantage is circumscribed, however, by the general constraints upon unduly restrictive solicitations.²¹⁴ Thus for example the incumbent contractor cannot be favored by requiring bidders to demonstrate their products' compatibility with the incumbent contractor's equipment at a location other than at the procuring agency.²¹⁵

The incumbent contractor's position in a negotiated procurement would appear to be more entrenched. Option exercise in the formally advertised context is essentially an open-market undertaking absent exigent circumstances or where informal market testing suffices. For example, in a formally advertised procurement the incumbent contractor may not reduce prices after solicitation to induce the Government to exercise an option.²¹⁶ To do so would permit a bid change which might displace an

otherwise low bidder. However it is proper to permit the incumbent contractor to lower its option price after responses to an RFQ in a negotiated procurement,²¹⁷ notwithstanding that the effect is displacement of an otherwise low offeror.

The market test thus can place the incumbent contractor in an unusual position. On the one hand his revealed option prices form the basis for the CO's decision to exercise or award to a new bidder. But on the other hand, any incumbent enjoys certain advantages owing to inertia: it is simply more convenient to exercise an option, especially in close cases, than to undertake a new procurement.

B. The Right to Exercise is the Government's

That Government possesses the absolute right to exercise an option appears well settled.²¹⁸ However this fundamental principle is often challenged when a contractor seeks to avoid or compel exercise in the face of contrary Government action.

1. Option Exercise: Contractor Seeks to Avoid

Virtually all cases addressing a contractor's efforts to avoid option exercise turn on the principles of untimely or otherwise non-conforming Government attempt to exercise (see infra Ch III, D). For example, untimely²¹⁹ or irregular²²⁰ notice of exercise, failure to conform to the contractual requirement of written exercise,²²¹ or that the attempted exercise was somehow equivocal²²² have been successfully urged by contractors in seeking to avoid option exercise. Assuming that the Government has complied with the requisite formalities, its right to exercise appears to be unquestioned.²²³ It is a unilateral right belonging to the Government.²²⁴

2. Option Exercise Where There is a Defect in the Basic Contract

The Comptroller General and Boards of Contract Appeal have consistently recommended against exercise of options where the underlying contract was improperly awarded. Thus where the Government improperly awarded to a low bidder who failed to meet stated responsibility standards, rather than recommend termination of the nearly completed basic contract, the Comptroller General recommended that the option not be exercised and that the Government's needs be resolicited.²²⁵

Similarly, exercise of an existing option was disapproved where the Government argued that specifications had been merely inconvenient to draft thereby failing to adequately justify negotiation of the underlying contract.²²⁶

Where the option quantity itself was improperly evaluated in the bid evaluation process (see Ch II, C) but performance of the basic contract was 60% complete, the Comptroller General recommended against option exercise.²²⁷ Other similar cases include award of a contract based on improperly calculated shipping costs,²²⁸ improper solicitation inherently favoring the incumbent contractor,²²⁹ failure to inform all bidders that solicitation requirements would be relaxed²³⁰ or failure to conduct meaningful negotiations.²³¹ The Comptroller General has held that he has no authority to order the Government not to exercise an option; relief should be pursued through the courts.²³² Thus although the Government has the unilateral right to exercise an option, this right is good only as long as the contract itself is free from defect.²³³

3. Non-exercise of an Option: Contractor Seeks to Compel Exercise

The Government has the concomitant right not to exercise an option.²³⁴ This right inheres in the nature of the option itself. Nonetheless, non-exercise of an option has given rise to contractor litigation.

Where the option is exercisable at the sole discretion of the Government, the Comptroller General no longer will consider the merits of contractor protests alleging that the agency should have exercised the option.²³⁵ Previously the Comptroller General had entertained protests against non-exercise.²³⁶ Those cases turned on the theory that although

the Comptroller General would not examine the CO's rationale, he would permit inquiry into the reasonableness of the CO's decision.²³⁷ This leaves open the question of the scope of reviewability which the Comptroller General will afford if the option is exercisable, but other than at the sole discretion of the Government. However, in Industrial Maintenance Services, Inc.²³⁸ the Comptroller General stated:

GAO does not consider a protest by an incumbent contractor as to whether or not a procuring agency should exercise its unilateral contract option instead of issuing a new solicitation. C.G. Ashe Enterprises, B188043, March 7, 1977, 77-1 CPD 166. There is no obligation on the part of the Government to renew such a contract and such determinations are solely the procurement agency's discretion ... (emphasis added)

This language appears to state that any option, so long as it is a unilateral contract option would be exercisable at the Government's sole discretion, hence not reviewable.

The Comptroller General's predisposition not to review these protests may be limited to cases where the Government declines to exercise an option either because it no longer has needs or decides to fill the need through competition. In a case in which Government's needs continued to exist and the Government had several different options through which it could fill the requirement, the Comptroller General permitted review of non-exercise of an option.²³⁹

At the onset, we must consider DOE's and CW's contention that our office should not consider the protest on its merits... The contracts provided:

'In the event that the Government fails to exercise its unilateral right to require the Contractor to proceed with the next succeeding phase, the Contractor is not authorized to expend any additional funds in excess of the amount obligated and set forth separately for each phase.'

... thus, DOE and CW maintain that by accepting the terms of the contract Westinghouse granted the Government an option exercisable at the sole discretion of the Government ... they argue ... we should not consider contentions that

the agency should have exercised a contract option provision which is purely for the interest and benefit of the Government.²⁴⁰

But the Comptroller General permitted review, stating:

We think it reasonably clear from DOE's conduct in this matter, at every stage, that it was essentially conducting a competitive procurement for Phase 2.²⁴¹

He then reviewed the merits of the protest alleging non-exercise.

Another, perhaps unusual, instance in which option non-exercise was reviewed occurred where the Court of Claims held the Government estopped to deny exercise. In that case, Menloading & Management Associates, Inc. v. U.S.,²⁴² the CO's representative made assurances to the contractor that funds were available and the Government intended to exercise an option to extend the performance period. The Government there had let a contract for transfer of records to magnetic tape knowing that the job would take two years and that very little of the work could be completed by the end of the fiscal year in which the contract was awarded. The contract contained the following language:

III. Production Requirement and Period of Performance

A. The Government anticipates that the work to be performed under this contract cannot be completed until Fiscal Year 1972. However, because of fiscal year limitations on funds, the contract to be awarded under this solicitation covers work to be performed through June 30, 1970.

B. This contract is renewable, at the option of the Government, by the Contracting Officer giving written notice of renewal to the Contractor, as specified below. If the Government exercises the option for renewal, the unit price shall be the same as in the initial procurement and the contract as renewed shall be deemed to include this option provision. However, the total duration of this contract, including the exercise of any options under this clause, shall not extend beyond June 30, 1972.²⁴³

Prior to submission of bids the Government held a preaward conference at which prospective bidders expressed concern about bidding a project to be completed in future fiscal years. The contracting officer's

representative advised bidders:

Sub-paragraph B under Section III, Production Requirements and Period of Performance ... was intended to afford the Government an option to terminate the agreement at the conclusion of any fiscal year subsequent to the letting of the contract in the event that funds were not appropriated to permit completion of the contract, but that any prospective bidder should be assured that funds were available and that there would be no questions about the renewal of the contract for the fiscal year beginning July 1, 1970.²⁴⁴ (emphasis in original)

Because of a successful bid protest the Comptroller General recommended that the agency not exercise its option to renew. The contractor sued alleging that it was entitled to rely on what it was told at this bidder's conference. The Government, relying on language in the Conditions Affecting the Work and Explanation to Offerors Clauses unsuccessfully argued that the matters addressed at the bidders conference, not being incorporated into the written contract, were merely pre-contract negotiations and not binding. The court found that the Government intended the successful bidder to provide personnel and supplies necessary to perform over more than a 2-year period. Further the plaintiff relied upon the Government's representative to its detriment. Applying estoppel principles, the court found that the Government could not now argue it had not exercised its rights to continue the contract.

In his dissent, Judge Nichols pointed out that the parol evidence rule should have precluded admission of the bidder's conference statement, the option language in the contract being unambiguous.²⁴⁵

Manloading produces a curious result. The court apparently took the view that the contract acquired the characteristics of multi-year procurement; the Government was obligated to continue the contract so long as funds were appropriated. Thus although the contractor prevailed

by arguing estoppel, it is not clear that the court applied the principles of option exercise in reaching this result. Further, although the contractor succeeded in contesting non-exercise, its remedy was limited to termination for convenience.

Similarly, in another case in which the result tended to blur the rules of option exercise, the Armed Services Board of Contract Appeal decided in favor of a contractor who suffered monetary losses when the Government did not exercise an option after having told the contractor it would do so.²⁴⁶ The contractor had obtained Vietnamese Piastres, thereafter becoming worthless, in reliance upon the Government's promise to exercise an option. Even though the option was never formally executed, and the contract terminated, the contractor was held to be entitled to relief notwithstanding a contrary GAO opinion.²⁴⁷ This result was largely driven, not by the law of options, but by the concept that "a contractor is entitled to expect fair dealings from his Government."²⁴⁸

Thus the Government has broad rights to exercise or not exercise an option. Additionally, there is very limited review of Government actions here. However a contractor might have his "day in court" if he can succeed in characterizing the Government's action as other than purely exercise or non-exercise of an option.²⁴⁹

C. Untimely or Otherwise Non-Conforming Attempt to Exercise

The Government, if it indeed does choose to exercise an option, is bound to rather strict rules concerning timeliness and clarity of the notification.²⁵⁰

1. Notice Must be in Writing

The exercise of an option must be by written notice.²⁵¹ However what constitutes adequate written notice can be questioned. Clearly where the Government is silent, exercise of an option will not be imputed.²⁵² Here comments by a Government official, although published in a local newspaper, but not directly transmitted to the contractor, do not rise to the stature of written notice effecting option exercise.²⁵³

But a written communication to the contractor, although not manifesting a present intent to exercise an option, may nevertheless be held to be effective exercise. Thus in Mills Manufacturing Corporation²⁵⁴ the Armed Services Board of Contract Appeals found adequate written notice of exercise where the Government sent a telegram to the contractor stating:

The Government proposes to exercise the option as provided for under provision JJ of contract AF36(600)-17513 for an additional quantity of 1033 each item one (1) ... request acknowledgement and any decrease in unit price...²⁵⁵
(emphasis added)

The Board found persuasive that although the contractor's president viewed the telegram merely as a Government proposal, the Government had told him telephonically that the telegram was itself a notice of exercising the option. The Government then sent a follow-up message requesting acknowledgement of its initial telegram. Acknowledgement was forthcoming only after the Government had prepared and presented a

contract modification, which the contractor eventually signed. The Board found that although the choice of language in the telegram was "admittedly not good",²⁵⁶ taken together with the contractor's phone call and the subsequent Government message, the option had been exercised. Present intent to do so had been manifested.

A well reasoned dissent pointed out that exercise here was not effective as a matter of law because inter alia it did not manifest a present intent to exercise the option.²⁵⁷

In a recent ASBCA case in which the requisite present intent to exercise an option was found lacking the Board said:

This Board, like the courts, considers an option to be an offer stated in specific terms the acceptance of which must be unconditional to be binding on the offeror. General Dynamics Corporation, ASBCA No 20882, 77-1 BCA 12504 and authorities cited therein. In manifesting exercise of an option, i.e. acceptance of an unconditional offer, a premium is placed on clarity of expression. Chemical Technology, Inc. ASBCA 21863, 25 September 1980, slip opn. at 18.²⁵⁸

In that case the Government argued that its notice to the contractor met the standard set forth in Mills Manufacturing, but the Board found that it was not until the option exercise period had lapsed that the Government sufficiently clarified its "exercise" notice.²⁵⁹

Therefore, it would appear that language indicating mere intent to exercise will not satisfy the notice requirement unless present intent can be found from a subsequent course of dealing between the parties before the option exercise period expires.²⁶⁰

2. Notice Must be Timely

It is axiomatic that timeliness is an essential ingredient to effective option exercise. However problems arise where the contract

does not specify a time for notice of exercise. Additionally problems can arise where the contract expresses an option exercise period, but which is later modified by mutual agreement.

a. Contract Silent Regarding Notice

Notice must be given during the option exercise period. However where the contract is silent as to when the contract option may be exercised, the option exercise period has been construed as being not beyond the contract period itself.²⁶¹ And where the Government ineffectually attempts to exercise an option during the term of the basic contract, an additional attempted exercise after this term expires is likewise without effect.²⁶²

b. Contract Express Regarding Notice

Where the contract expressly sets forth an option exercise period, this period governs and is strictly applied.²⁶³ Exercise of an option was held to be untimely where the contract required preliminary notice of exercise "at least 60 days before the expiration date of the contract" and the Government computed this date using the general rule that in computing a period of one year, the day the event occurs should be excluded, but that contract stated its "effective date" as being its first day.²⁶⁴ The expiration date there was held to be one day earlier than the Government had assumed; notice was held to have been untimely.²⁶⁵

International Telephone and Telegraph, ITT Defense Communications Division²⁶⁶ (hereinafter: ITT) is instructive on this point. Although the facts deal with Government notice of funds availability under

multiyear contracting, the principle of timeliness and exact conformance to express contractual requirements apply with equal force to option contracts. The relevant contract language in ITT called for notice of funds availability be given in writing on or before 15 August, the date specified in the schedule. The CO sent such notice by telegram on 15 August but the telegram was not received until the morning of 16 August. Additionally the CO had spoken with a representative of ITT on 15 August informing him of the contents of the telegram. The issue then became: did timely oral notice coupled with untimely written notice effectively exercise Government rights. In holding in the negative, the court stated:

In fact, the Board sought to distinguish the Dynamics case, where we held the written notice had to be issued by the government and received by the contractor during the contract period to be effective, from the instant case by saying there was not oral notice given in Dynamics. We think the Board read too much into the oral notice and erred in making it the dominant and controlling factor in its decision. The parties never contemplated the giving of an oral notice and such a notice is not even mentioned in the contract. The oral notice is actually immaterial in affecting the legal rights of the parties and cannot, either singly or together with the late and untimely written notice, control the decision in this case...²⁶⁷

The court concluded that timeliness of notice was essential and here lacking; oral notice simply did not conform to express contractual requirements. Thus the Government will be strictly and literally held to the letter of its contracts in matters of timeliness of exercise.

c. Effect of Contract Amendments: Acceleration and Delays

Although notice of exercise must be given within the option exercise period (or, if none stated, within the contract period), that period itself may be shortened or lengthened by mutual agreement. Contract extensions or accelerations, however, which do not expressly address

option periods can present a problem of interpretation.

In one case the contractor argued that acceleration of contract performance necessarily shortened the option exercise period.²⁶⁸ The option clause read as follows:

6.103 Option for Increased Quantity ...

(B) This option may be exercised at the time of award or from time to time after date of award up to ten days prior to the final specified delivery date for the supplies as provided by the contract or any amendment thereto; however, the Government, without waiving its rights hereunder, reserves the right to negotiate for lower unit prices and earlier delivery prior to exercising of the option. A written notice mailed or otherwise furnished by the contracting officer to the contractor within the time specified shall constitute an exercise of the option²⁶⁹ (emphasis added)

The contract originally provided for final delivery 720 days from date of award, hence the option could be exercised any time up to and including the 710th day.²⁷⁰ However, the contract was subsequently modified thereby accelerating final delivery. But on the 710th day the Government notified the contractor that it was exercising the option. When confronted with the contractor's protest, the Government made the rather unusual argument that its option clause was ambiguous; that it did not ipso facto shorten the option exercise period by its own terms where the contract performance period was shortened.²⁷¹ The Government argued that the phrase "or any amendment thereto" referred only to extensions of delivery date, but was not intended to reduce the option period in the event of acceleration.

The GAO held that the phrase "or any amendment thereto" which appeared in the option clause was indeed ambiguous. But the usual rule of contra proferendum was here inapplicable because dealings between the parties subsequent to the contract modification served to construe the ambiguity. Thus in spite of acceleration of the basic contract, the

Comptroller General found that:

[O]n balance, the record supports the conclusion that it was not the intention of the parties to shorten the option period when they modified the contract to accelerate the delivery date.²⁷²

The converse situation can be equally fraught with problems for both the Government and the contractor. For example, in Keco Industries, Inc.,²⁷³ the contractor argued that a modification which extended the contract did not extend the option exercise period. In that case it was the contractor arguing that the option clause was ambiguous. It read as follows:

The Government reserves the right to purchase additional quantities of the items specified. This may be any quantity up to but not exceeding 50% of the total quantity awarded, irrespective of destination. The Government may exercise this option by written notice to the contractor any time prior to one hundred and twenty (120) days before the scheduled final delivery in effect at the time of any exercise of the option. Such option may be exercised by cumulative notices thereof within the period specified...²⁷⁴ (emphasis added)

Thereafter, following start-up problems caused by defective Government furnished property, a modification extending the contract by 120 days was executed, but no mention of the option provision was made either in the written modification or orally or in writing between the parties outside the contract. In interpreting the impact of the contract extension the ASBCA focused on evidence of the intent of the parties, but concluded that the option clause was not intended to afford the Government an extended period to exercise the option.²⁷⁵ This was so, in the view of the ASBCA, because it was the Government's own misconduct which brought about the delay, to wit: defective GFP. Although the literal reading of the clause might compel the opposite result, the Board said, it is "obliged to interpret contract provisions in a manner which

yields rational results."²⁷⁶

The Board went on to state:

Appellant has argued that as a matter of public policy we should refuse to give effect to the option clause due to its open-ended feature. We elect not to do this, even if our jurisdiction authorized us to reach such a result. We are not confronted here with a case where the contractor required additional performance time due to its own fault or negligence, or here a delivery schedule extension is otherwise mandated by circumstances other than the fault of the Government.²⁷⁷

Thus, in cases where the contract is modified to extend or accelerate performance, if the modification is silent concerning its effect on an option provision, the rule would appear to be that the parties intent will govern. And intent will be determined from contemporaneous and subsequent conduct, writings, or both.²⁷⁸

1). "Slip and Slide" Options:

The so-called "slip and slide" option has provided a certain amount of flexibility by tying option exercise to the occurrence of a specified event rather than elapsed time.²⁷⁹ This format generally provides that exercise, to be timely, must be effectuated within a stated number of days after, for instance, first article approval.

In Lear Siegler, Inc.,²⁸⁰ an option exercise provision which was contained in the Schedule read as follows:

The Government may exercise any and all said options up until thirty (30) days after Contractor's receipt of written First Article approval under paragraph twenty-five of this invitation ...

The contractor argued that this option arrangement was invalid because the referenced paragraph twenty-five arguably set forth no specific time for completion of first article testing. It stated:

It is expected that one hundred and twenty (120) days will

be required to complete testing of the Contractor's First Articles.²⁸¹ (emphasis added)

The Government was responsible to provide written notice to the contractor concerning approval or disapproval of the first articles. The Board concluded that this meant the Government was required to provide unilateral notice to the contractor. No such notice was issued. Instead, the Government, on 14 September 1965, sought to resolve certain first article discrepancies through negotiation. On 14 October 1965 the Government then transmitted a written contract modification which the contractor properly construed as in part being a first article approval. The Board construed this entire option exercise effort violative of

clear Departmental guidance to the effect that an option contract shall fix the period within which the option may be exercised, and that time period in all cases shall be kept to a minimum, for the stated reason that options require offerors to guarantee prices for definite periods of time with no assurance that orders will be placed ...

The option arrangement in the subject contract did not reflect these stated principles of fairness. The period within which the option might be exercised was not fixed for a specified definite period of time, but was open-ended and in part subject to control by the optionee.

The option period expected at the time of award in June 1962 would have closed in December 1963, with risk period of about eighteen months. Under (the Government's) interpretation of the time-free provisions, that risk period was more than doubled to a period of nearly three and one-half years ending in November or December 1965... (The Government's) substantial contribution to later delay in the issuance of a proper notification of first article approval further compounded that unfairness.²⁸²

The Board then found that the attempted option exercise came later than thirty days after first article approval, hence amounted to a constructive change.²⁸³

The "slip and slide" option can eliminate much of the uncertainty surrounding the effect on options of contract acceleration or extension.

However, if the event to which the exercise period is tied is delayed because of Government fault, the rule, if it can be stated at all, would appear to disallow extending the option exercise period.

d. The "Mailbox" Rule

In its most pristine sense, timeliness of exercise is a matter of rather straightforward rules. Notice of exercise is effective when received by the contractor. This is true at common law as well.²⁸⁴

This rule was reiterated by the Court of Claims in Dynamics Corporation of America.²⁸⁵

Turning now to the general rule governing exercise of an option, it is well settled that notice to exercise an option is effective only upon receipt... [citing 1A Corbin, Contracts §264 at 521 (1963 ed)].

The courts are in general agreement with this rule. 'It is at least the majority rule that notice to exercise an option is effective only upon receipt by the party to be notified unless the parties otherwise agreed ...'

Finally, a reading of the Armed Services Procurement Regulations, ASPR 1-1505, 32 C.F.R. §1.1505 (1967), indicates that the Government itself recognizes the validity of the general rule.

....
(a) The exercise of an option by the Government requires the contracting officer's written notification to the contractor within the time period specified in the contract.

3. Effect of Non-Conforming Attempt to Exercise: Contract Change

It is also true in both Government contract law as well as at common law that the exercise must be unconditional and in exact accord with the terms of the option to be effective.²⁸⁶ Under common law rules a non-conforming attempt to exercise is merely no exercise at all.²⁸⁷ But in Government contracting untimely or non-conforming attempt to exercise generally results in a constructive change.²⁸⁸

a. Constructive Change

The constructive change doctrine has been applied in cases where the attempt to exercise an option was non-conforming and the contractor continued work. In General Dynamics Corporation, ASBCA No. 20882, 77-1 BCA ¶12,504, (1977), there was a contract for radar modification kits with an option to order additional kits in writing on or before 18 June 1974. On 17 June the contractor received written notice for an additional five kits pursuant to the option. However notice of exercise deviated from the contract delivery schedule; the Government required a delay of eight months rather than continuity of performance. The CO gave timely oral correction to the attempted exercise, but written correction arrived at the contractor on 19 June. The Board held that:

An option is an offer couched in specific terms, the acceptance of which must be unconditional and in exact accord with the terms offered ...

....

... The Government's written correction was received by the appellant the day after the option expired and thus was ineffective because of untimeliness. A timely oral notice plus an untimely written notice does not equal a timely written notice when that form of notice is mandated, as it was by this contract ...

....

The Government's argument that the appellant, by electing to proceed with performance under the order for additional quantities, waived its right to challenge the manner in which the option was exercised and to obtain payment in excess of the options not-to-exceed price has no merit.

The Government's argument overlooks the clear mandate of the Disputes clause which reads as follows

'Pending final decision of a dispute hereunder, the contractor shall proceed diligently with the performance of the contract and in accordance with the Contracting Officer's decision.'

....

In short, the disputes clause of the subject contract compelled the appellant to comply with the Government's direction, and the appellant's delivery of goods under protest did not deprive the appellant of its right to recover beyond the terms of the contract.

The appellant, having delivered additional kits pursuant to the Government's direction, is entitled to be compensated therefor. The option clause, having been found to be inapplicable because of the Government's invalid action thereunder, the question presented is may this Board compensate appellant under any provision of the contract?

The appellant seeks an equitable price adjustment under the changes clause arguing that the order to furnish additional quantities under the contract constitutes a constructive change. In support of its position, the appellant cites International Telephone and Telegraph, ITT Defense Communications Division v. The United States ... Keco Industries ... and ... Lear Siegler, Inc.... In all of those cases performance under an invalid option order was held compensable as a constructive change order.

The Changes clause of this contract limits itself specifically to modification affecting drawings, designs or specifications, methods of shipment and/or packing and places of delivery. Thus, the author of this opinion would hold that the appellant's claim is not redressable under the clause since neither this Board nor the courts may rewrite, by an indiscriminating use of the constructive change doctrine the parties['] own contract....

The majority ... however, are of a mind that the appellant's claim is compensable under the contract as a constructive change in accord with the precedent of the cases cited supra

Thus, although the Changes clause, as generally written, does not literally embrace contractor performance following an invalid option exercise, it has been read so as to provide contractor relief in such cases.

An even more compelling example of application of the constructive change rationale is found in the recent case of J.E.T.S., Inc.²⁸⁹ In this case the CO not only failed to give timely written notice informing J.E.T.S. of the Government intention to exercise an option to extend, but also included an Availability of Funds Clause in the purported option exercise itself. The Availability of Funds Clause included the following language:

No legal liability on the part of the Government shall arise unless and until funds are made available to the Contracting Officer for the procurement and notice of such

availability, to be confirmed in writing by the Contracting Officer, is given to the contractor

Without reaching the question of the effect of the arguably untimely notice of intent to exercise, the ASBCA held that inclusion of the Availability of Funds Clause in the contract modification (the option exercise) made the exercise conditional hence invalid.

It is well settled that in order for the Government to properly exercise an option, its acceptance of the offer must be unconditional and in exact accord with the terms offered. See General Dynamics Corporation ASBCA No. 20882, 77-1 BCA ¶12,504.... Here the purported execution of the option included the availability of funds clause and made the execution conditional upon subsequent availability of funds for performance of the contract and written notice to appellant of such availability. It is undisputed that funds were not available for performance during the option period on or before the date for acceptance of the option, 15 April 1981, nor by the date of commencement of the second year of the contract, 1 May 1981.

... While compliance with the Anti-Deficiency Act, 31 U.S.C. §655(e) which forbids the incurring of obligations in advance of available appropriations to pay for them is inherent in every Government contract, here the contracting officer made execution of the option which covered portions of the current fiscal year and the next fiscal year specifically dependent on the availability of funds for the entire period of the option term and notification thereof to appellant. It is the inclusion of the clause not the method of funding which made the option exercise conditional ... By (including the clause) he varied the terms and conditions of the contract by introducing a new limitation on the exercise of the option ...

....

... Appellant's continued performance constituted a constructive change for which it is entitled to an equitable adjustment...²⁹⁰

Thus the rationale of General Dynamics is viable; the rule requiring strict adherence to the exact terms and conditions of the option appears to be strictly applied. It is probably safe to conclude, in light of J.E.T.S., that the inclusion of any language which varies the terms of an option will render an attempted exercise invalid. Continued contractor performance in such a case would be compensable as a constructive change.²⁹¹

b. Waiver of Non-conforming or Untimely Exercise

Waiver of a defective attempted exercise has been found where a contractor performed the optional work without protest.²⁹² Lockheed Electronics Company, Inc., ASBCA No. 16667, 72-1 BCA 99442, (1972) is particularly interesting in this regard in light of J.E.T.S. (supra). There the Board found that the doctrine of waiver precluded contractor recovery of additional amounts under an equitable adjustment stemming from an arguably defective option exercise notice.²⁹³ Like J.E.T.S., Lockheed involved inclusion of the availability of funds clause in an attempted option exercise. Interestingly, Lockheed held that inclusion of that clause did not cause the attempted option exercise to vary the terms of the basic contract. This in spite of the fact that the basic contract did not contain a availability of funds clause. The Board determined that since the clause was in the solicitation, that the solicitation had been incorporated into the contract.

Notwithstanding the arguable invalid exercise however, the Board noted that Lockheed had waived whatever rights it had to protest this issue by performing without protest.

Additionally we have found that appellant accepted the document exercising the option without protest; that it also accepted the change order operating as a notice of availability of funds for a second year without protest; that it thereafter accepted delivery orders for more than 100 machines and performed the work, all without protest; and thereafter, more than a year after the work had been completed, brought this argument up the first time. Under these circumstances, it is clear that any purported deficiency in the exercise of the option was waived on several occasions, to the detriment of the Government in that the latter was thereby deprived of the opportunity to properly evaluate the feasibility of performing repairs at the higher cost now claimed by the appellant. This waiver may not be revoked belatedly...

Thus waiver appears to require both inaction by the contractor as

well as some measure of detriment to the Government. It is not clear exactly at what point a contractor will be held to have waived its right to assert that a purported option exercise was invalid. It is likely however that if the contractor substantially undertakes to perform the optional work without protest, the doctrine of waiver will apply.

Thus, it is possible to have a defective (untimely or non-conforming) notice of option exercise made good by contractor performance without protest.

D. The Option to Negotiate: The Unpriced Option

Exercise of the unpriced or "soft" option presents some interesting issues. The fact that the price term of a contract remains to be negotiated does not render the agreement any less enforceable.²⁹⁴ This applies with equal force to an option contained within a contract.²⁹⁵

1. Exercise of an Unpriced Option

The unpriced option is an option to negotiate for additional items or continuation of the contract.²⁹⁶ Implicit in the terms of such an option is that the parties will negotiate in good faith.²⁹⁷ But the exercise of the option to negotiate does not per se entitle the contractor to award of the option portion of the contract.²⁹⁸

The preliminary inquiry surrounds what, in fact, constitutes exercise of an unpriced option. As in the more conventional, priced, option, exercise constitutes the acceptance of the contractor's continuing offer. In Fox International, Inc.,²⁹⁹ the Comptroller General held that Government notification that it intended to exercise an unpriced option was insufficient notice of exercise (citing Mills, supra). The option clause read as follows (in relevant part):

(a) At the option of the Government, the Contractor shall negotiate in good faith with the Government for the continuation of services of the general type hereunder using as a basis for the negotiation the terms and conditions of this contract; provided that, the Contracting Officer notifies the Contractor in writing of the intention to negotiate for such continuation at least (90) calendar days prior to the 30th day of June of the current fiscal year, except that no services may be continued beyond 30 June 1977. If the performance of services is to be continued though the exercise of this option, the Contracting Officer shall notify the Contractor of the date on which such performance is to begin.

(b) The Contractor may refuse to continue services of the general type hereunder beyond the 30th day of June of

the current fiscal year, provided that, the Contractor notifies the Contracting Officer in writing of the intention not to negotiate for such continuation at least one hundred and twenty (120) calendar days prior to the 30th day of June of the current fiscal year.

....
Within 30 days from the Contractor's receipt of the Contracting Officer's intention to exercise an option for renewal, the Contractor shall submit a proposal for the continuation of contract performance for the ensuing 12 months period. The parties agree to negotiate in good faith within the cost limitations for such option period as set forth in this Article to formulate an equitable cost, for each extended yearly period of performance. The parties further agree that this ratio of profit to costs for such periods of performance of the contract shall not exceed that ratio negotiated for the initial contract period.

(e) In the event that the parties fail to agree on costs for an option period prior to expiration of the current contract term, the Contracting Officer, in writing, may direct the Contractor, subject to availability of funds, to continue contract performance for an additional 90 days period, and the Contractor shall continue to perform as directed. During the first sixty (60) days of this extension period the parties shall continue negotiations toward an agreement on costs and profit for the one year option period. A failure to agree on costs and profit for the one year option during the first sixty (60) days of the yearly extension shall result in the Contracting Officer rendering a unilateral decision as to what estimated cost and profit is reasonable under the circumstances for the one year extension and said decision shall constitute a decision rendered under the ... terms of the 'Disputes' clause ...

The Comptroller General held that under the terms of the above quoted option clause, the issuance of a letter of intent merely set in motion certain negotiation procedures which could result in a one year contract extension if the parties agreed on terms. Further, that although the Government was obligated to enter good faith negotiations,

[We do not believe that the clause requires the Army to actually exercise the option, when subsequent to the issuance of the letter of intent, the Army in good faith determines that it would not be in the Government's best interest to extend the contract for a year ...³⁰⁰

The Comptroller General apparently took the view that notification

fell short of actual exercise. It would appear that under these facts, he would define exercise as being effective only after the parties had agreed to a price.

Compare Cummings & Sellers, 43 Comp.Gen. 451 (1963), where the Comptroller General took a somewhat different approach as to what constitutes exercise of an unpriced option. There the option clause read:

1. Upon receipt of written notice by the Contracting Officer, the Contractor will, within 15 days, submit its complete proposal in such reasonable detail as the Contracting Officer may require.

2. Following proposal receipt by the Government, the parties will enter into negotiations in good faith to negotiate such additional work on a lump-sum, fixed price basis. Only in the event that it shall become apparent to the parties that a fixed-price continuation cannot be negotiated will any other method of contracting be considered.

3. No work ... will be performed until such time as so authorized by written amendment to this contract.

....

d. If ... the parties are unable to agree upon the terms and conditions for continued performance, then the Government shall have the right to terminate negotiations with the contractor.

The Government requested the contractor to submit a proposal within the 15-days as set forth in the contract, but no negotiations were undertaken. As in Fox, the Government had determined that its best interest would be served by procuring elsewhere. The contractor argued that the Government's request for proposals within 15 days under the option was an exercise of the option, therefore a binding contract came into being, remaining only to be priced. But the Comptroller General held that the Government is not legally obligated to award a contract solely because it requested proposals for negotiation purposes.

Surely, the Government which has the clear legal right to refuse to make any award under competition advertised procedures, has an even more justifiable right to refuse to negotiate under an option for the sole benefit of the Government pursuant to more liberal procedures ... we feel

that ... the request for a proposal constituted nothing more than a preliminary step which legally contemplated a written formalization of the agreement of the parties to the option.³⁰¹

Thus, under both Fox and Cummings & Sellers, notification by the Government to the Contractor to provide proposals for extension of the contract under the option provision was not option exercise. In Cummings, this notice was equated to notice of intent to exercise in the future as was discussed in Mills Mfr. Co.³⁰² In Cummings & Sellers this notice was equated to an ordinary request for proposals which would give the optionee contractor no greater rights than any other prospective offeror under an RFP. Under the Cummings rationale it would seem that an unpriced option can not be exercised short of executing a new contract document for the "optional" items or period of performance. Logically, this transposes the position of the parties from where they would usually be in an optionee-optionor setting to that of offeree-offeror as in any pre-contract award negotiation.

2. Contractor's Rights Upon Exercise

But assuming, arguendo, there is a definable Government undertaking which can be called "exercise," it would appear that the Government's only obligations are to begin good faith negotiations.³⁰³ There is no legal requirement to award the optional quantity, although the option has been "exercised."³⁰⁴ Unpriced options are characterized as "binding," notwithstanding that the price term is not definite or ascertainable but is left to future negotiation.³⁰⁵ However, exactly what the parties are "bound" to is somewhat speculative.

An option clause which fails to express or refer to a price term will be construed as an option to negotiate the price.³⁰⁶ Thus an option which read:

Clause VII OPTION: The Government reserves the right of option to extend service through the period 1 July 1965 - 30 June 1966, and 1 July 1966 - 30 June 1967. If the Government exercises its option, notice will be given to the Contractor not less than 60 days prior to expiration of this contract.

was held to be an option to negotiate price notwithstanding that the Government contended that it had a option thereby to extend services at the stated basic contract price.³⁰⁷

It would seem that this brings the analysis full circle. Begin with the proposition that a contract with the United States is nonetheless a binding contract in spite of a lack of a price term.³⁰⁸ Thence to the point that the parties to an unpriced option are "bound" to little if anything, except to negotiate in good faith. Finally, an option without a price term can be an option to negotiate, or something short of a binding option. What, indeed, is the "binding" nature of the contract lacking a price term in this context? Thus, although their use appears to be widespread, the unpriced option presents nice, if puzzling, questions of mutuality and enforceability which have not been addressed in the cases.

E. Exercise Issues: Indefinite Quantity Contracts

Indefinite Quantity Contracts like option contracts provide procurement flexibility, but unlike options, indefinite quantity contracts are characterized by the inclusion of a minimum order requirement (see Ch I, §B2). Legal issues surrounding "exercise", if that term may be applied, have not concerned so much the technical fine points of timeliness and conformity as whether or not the Government has ordered the minimum quantity and the effect of not having done so, as well as the Government's obligation to order a maximum quantity.

So long as the Government places its order for additional quantities during the life of the contract, it would appear that such orders will be timely.³⁰⁹ Additionally, there appear to be no requisite formalities of exercise, such as a writing,³¹⁰ except as may be dictated by practical judgment and the contract itself. It is not necessary to "test the market" before ordering additional quantities, however the Government may do so if it chooses.³¹¹

1. Requirement to Order a Minimum Quantity

An indefinite quantity contract must set forth a minimum quantity in order to embody requisite mutuality of obligation. Otherwise it will be enforceable only to the extent performed.³¹² The minimum quantity must be more than a nominal quantity.³¹³

Inclusion of a Termination for Convenience clause does not make an Indefinite Quantity contract less valid.³¹⁴ Indeed, where the Government fails to order the minimum quantity set forth in the contract, a constructive termination for convenience will be found.³¹⁵ Thus, despite the contractor's assertion that it was entitled to the stated

minimum amount of money under a one-year indefinite quantity painting contract, the Government's failure to order the minimum quantity of work was treated as a termination for convenience.³¹⁶ The Government therefore paid only the termination settlement. But where the Government does order the minimum quantity, it probably cannot, where termination for convenience is appropriate, cancel a contract with a portion of the performance period remaining.³¹⁷

Typically an indefinite quantity contract will set forth not only a minimum quantity thereby establishing consideration, but also a maximum quantity as well.

The indefinite quantity contract, including minimum and maximum quantities, is a special kind of option contract under which the Government is bound to order and receive the minimum quantity and cannot be required to take more, but may require the contractor to deliver up to the maximum quantity.³¹⁸

An indefinite quantity contract, then, does not per se entitle the contractor to award of any amount beyond the minimum. The contractor's right to compel the Government to award any amount above the minimum are akin to similar rights in an optionee. Thus where an indefinite quantity contract set forth a minimum quantity of 225 and a maximum quantity of 500 radio synthesizers, the Government was contractually obligated to order only 225 units.³¹⁹

Under an indefinite quantity option contract the contractor is guaranteed orders for the basic or minimum quantity. There is no promise or legal obligation on the part of the Government to satisfy its requirements for this type of services or supplies from available options, and, if it so chooses, the Government could procure additional quantities of such supplies and services from other sources ... a holder of [such a] contract is thus put on notice of the risk it would assume in relying on the maximum quantity estimate for pricing purposes.³²⁰

2. Contractor Rights to Avoid Exercise

A contractor may seek to avoid Government efforts to order against the indefinite quantity contract. Contractors have unsuccessfully urged that such orders violate Anti-deficiency Statutes,³²¹ or contravene the Advertising Statute³²² or that use of cost reimbursable contracts with indefinite quantity provisions is inappropriate.³²³ However where it can be shown that the underlying contract was defectively awarded the contractor may be able to successfully refuse to honor Government orders if it chooses to do so.

For example, one such case arose where the IFB permitted acceptance within 30 days of bid opening.³²⁴ More than 30 days following the bid opening, the Government simultaneously sent appellant notice of award and an order for the minimum quantity. Appellant supplied the minimum quantity, but refused to supply additional items when the Government ordered the balance up to maximum amount. The Board held:

An indefinite quantities contract is not enforceable unless there is mutuality of obligation. Normally this is afforded by the agreement to place a minimum order. Mere part performance of a contract which is not binding on the parties does not make it binding to the extent that it is executory. (emphasis added)

....

In the instant case, no bilateral contract came into existence from the purported acceptance, for it was late. The purported acceptance, together with the minimum quantity order, constituted a counter-offer which was accepted by appellant's performance. The appellant delivered and the Government paid the agreed price. That contract was completed.

No contract for any additional quantity then existed ...³²⁵

In a dissenting opinion, it was pointed out that the contract in this case consisted of the entire quantity up to the maximum, hence appellant's acceptance of a partial order must be deemed to extend to all

terms and conditions of the contract.

Thus, under the majority's reasoning, an indefinite quantities contractor could well find refuge in some defect in the formation of the underlying contract where it was seeking to avoid performing beyond the minimum quantity.

Exercise of the Government's rights to order against an indefinite quantities contract appears, then, to be rather straightforward. There are few legal pitfalls here. Nonetheless the Government must use care in assuring that the contract sets forth a sufficient minimum quantity to make it binding. Otherwise attempted "exercise" by ordering additional quantities can fail.

CONCLUSION

This paper has reviewed the numerous rules, regulatory as well as case derived, concerning the use of options in Government contracts. Options are valuable legal tools which allow the Government contracting flexibility it would not otherwise have. Fiscal constraints imposed by annual appropriations can be overcome by their use. Long term needs, not perfectly predictable, can be contractually provided for by options. Indeed the Government can obtain a position in the market against rising prices by prudent use of the contract option.

But the Government, as well as the contractor must be aware of the many rules which attend their applicability, evaluation, and exercise. The legal pitfalls associated with these areas have been herein addressed. If a common thread of discussion can be found concerning all the option rules it is that the option places the contractor in essentially a sole source position for that particular procurement. Thus the applicability, evaluation, and exercise rules generally are circumscribed by efforts to foster competition in the "out-years", the years in which the options would be in effect.

So, although an option contract is arguably one which does not bind the Government contractually, consider whether perhaps the rules pertaining to their use bind the Government in other ways.

1. See also FPR 1-1.1501 which contains substantially similar language.
2. 10 Op. Atty. Gen. 93 (1861).
3. Id. at 93-94.
4. 16 Op. Atty. Gen. 183, at 184 (1874).
5. 9 Comp. Dec. 569 (1903).
6. Id., at 570.
7. Id.
8. 3 Comp. Dec. 221 (1897); 3 Comp. Dec. 188 (1896); 4 Comp. Dec. 446 (1898); 4 Comp. Dec. 544 (1898); 5 Comp. Dec. 687 (1889); 6 Comp. Dec. 949 (1900); 7 Comp. Dec. 62 (1900).
9. 23 Comp. Dec. 116 (1916).
10. Id.
11. 9 Comp. Dec. 569 (1903), supra, note 5.
12. Id.
13. Title XL, Revised Statutes, §3648, 1878.
14. 20 Comp. Dec. 509 (1913).
15. 31 U.S.C. 529.
16. Id.
17. But cf. 14 Comp. Gen. 59 (1934).
18. DAR 1-1501; FPR 1-1501.
19. 41 Comp. Gen. 682 (1962).
20. 42 Comp. Gen. 102 (1962).
21. Blacks Law Dictionary 777 (Revised 4th ed. 1968).
22. Federal Electric Corporation, 47 Comp. Gen. 155 (1967).
23. See, e.g., DAR 1-1502(b)(iii).
24. 41 Comp. Gen. 682 (1962), supra, note 19.
25. Federal Electric Corporation, supra, note 22.
26. Id.

27. FPR 1-3.409(c).
28. Radionics, Inc., ASBCA No. 20796, 77-1 BCA ¶12,448 (1977).
29. Id.
30. Id.
31. Neil A. Goldwasser, d/b/a Century Offset Company v. U.S. 163 Ct. Cl. 450 (1963).
32. Id., at 453.
33. Id.
34. Id., at 455.
35. Id.
36. Id.
37. James Mason, individually and as President of Sommers Construction Company, Inc, and Sommers Construction Company, Inc., a corporation v. U.S., 615 F.2d 1343 (Ct. Cl. 1980).
38. Id., at 1345.
39. Id., at 1348, 1349.
40. See, e.g., DAR 3-410.2.
41. DAR 3-410.2(c)(2).
42. 51 Comp. Gen. 755 (1972).
43. Tymshare, Inc., 57 Comp. Gen. 434, 78-1 CPD ¶332 (1978).
44. DAR 3-410.2(c).
45. Tymshare, Inc., supra, note 44.
46. DAR 3-410.2(c).
47. Tymshare, Inc., supra, note 44.
48. Comp. Gen. B-169209, June 11, 1970 (Unpub.).
49. DAR 3-410.2(c)(2)(i).
50. Rotair Industries; D. Moody & Co., Inc. Comp. Gen. B-190392, 78-2 CPD ¶410 (1978).
51. Id.

52. See, e.g., Department of Health, Education, and Welfare's use of basic ordering type procedure, 54 Comp. Gen. 1096, 75-1 CPD ¶392 (1975); Dept. of Agriculture's use of Master Agreement, 54 Comp. Gen. 606, 75-1 CPD ¶40 (1975).
53. Grey Advertising Inc., 55 Comp. Gen. 1111, 76-1 CPD ¶325 (1976).
54. See, e.g., DAR 1-1502(a). Compare the language which permits use of options to increase quantity requiring that the increased requirements be foreseeable. Options to extend performance period would thus appear to be held to a less stringent test of applicability. This dichotomy does not appear to exist under FPR. See, e.g., FRP 1-1.502 which permits use of options, regardless of type, if it is in the Government's best interest.
55. 9 Comp. Gen. 6 (1929).
56. Id., at 7 citing Act of August 13, 1914, 38 Stat. 690.
57. Id., at 8.
58. 42 Comp. Gen. 276.
59. Id., at 274, reciting 41 U.S.C. 11, 31 U.S.C. 665(a), 31 U.S.C. 712(a).
60. Id., at 274-5.
61. Id., at 276.
62. Id.
63. 43 Comp. Gen. 215 (1963).
64. Id., at 216.
65. 43 Comp. Gen. 657 (1964).
66. Id., at 660, 661.
67. Waukesha Motor Company, Comp. Gen. B-178494, 74-1 ¶CPD 329 (1974).
68. DAR 1-1502; FPR 1-1.1502.
69. Varo Inc., ASBCA No. 13739, 70-1 BCA ¶8099 (1969).
70. Id.
71. ITT Federal Laboratories, ASBCA No. 12987, 69-2 BCA ¶7849 (1969).
72. Id.
73. International Telephone and Telegraph, ITT Defense Communications Division v. U.S., 197 Ct. Cl. 11, 453 F.2d 1283 (1972).

74. 17A C.J.S. Contracts §449.
75. 41 U.S.C. §§351-58.
76. 48 Comp. Gen. at 721.
77. See, e.g., Geronimo Service Co., ASBCA Nos. 14686, 14687, 70-2 BCA ¶8540 (1970).
78. 48 Comp. Gen. 494 (1969).
79. 48 Comp. Gen. 497 (1969).
80. Id., at 502; see also Comp. Gen. B-165013, January 31, 1969, (Unpub.).
81. 11 Govt. Contractor ¶140, Note following.
82. 37 Comp. Gen. 155 (1957).
83. Id., at 159.
84. Burroughs Corporation, 56 Comp. Gen. 142, 76-2 CPD ¶472 (1976).
85. Honeywell Information Systems, Inc., 56 Comp. Gen. 167, 76-2 CPD ¶475 (1976).
86. Burroughs Corporation, supra, note 85.
87. Id.
88. Honeywell Information Systems, Inc., supra, note 86.
89. Burroughs Corporation, supra, note 85.
90. 41 CFR 101-32.4085 (1976).
91. Mobilease Corporation, 54 Comp. Gen. 242, 74-2 CPD ¶185 (1974).
92. Burroughs Corporation, supra, note 85.
93. Interservice Systems, Inc., 60 Comp. Gen. 331, 81-1 CPD ¶222 (1981).
94. ADP Network Services, Inc, Comp. Gen. B-193817, 79-1 CPD ¶163 (1979).
95. DAR 4-1104.10; 41 CFR §101-35.210.
96. Federal Data Corporation, Comp. Gen. B-194709, 81-2 CPD ¶28 (1981).
97. Id.
98. See, e.g., FPR 1-1506.
99. Comp. Gen. B-173141, October 14, 1971 (Unpub.).

100. Comp. Gen. B-146374, September 20, 1961 (Unpub.).
101. Id.
102. 15 Comp. Gen. 1136 (1936).
103. Comp. Gen. B-162839, December 19, 1967 (Unpub.).
104. Safemasters Company, Inc, 58 Comp. Gen. 225, 79-1 CPD ¶38 (1979).
105. Id.
106. Mobilease Corporation, 54 Comp. Gen. 242, 74-2 CPD ¶185 (1974).
107. Raytheon Company, 54 Comp. Gen. 169, 74-2 CPD ¶137 (1974).
108. Mobilease Corporation, supra, note 9.
109. Ainslie Corporation, Comp. Gen. B-190878, May 4, 1978, 78-1 CPD ¶340, Cf. Con-chem Enterprises, 52 Comp. Gen. 604, 77-2 CPD ¶284, (1977).
110. Milton Machine Corp., 46 Comp. Gen. 434 (1966).
111. See 9 Government Contractor ¶7.
112. Arden Engineering Company, Inc., 41 Comp. Gen. 709 (1962); 50 Comp. Gen. 583 (1971).
113. Comp. Gen. B-158902, April 18, 1966 (Unpub.).
114. Arnold & Porter, 52 Comp. Gen. 604 (1973). This case is not clearly an option case. The contract in question was a requirements type for a basic quantity plus follow-on quantities. Nonetheless, the Comptroller General stated therein: "(The protester argued that clerical error rationale was inapplicable) because the item in question must be ordered and, thus, does not conform to the statement in the decision that the item 'might or might not be ordered.' We believe that you have attached undue importance to that statement which merely described an additional feature of the procurements being compared. It was not intended to establish the uncertainty of ordering as a criteria for application of the pricing pattern rule which was there being observed." Thus "clerical error" would appear to apply with equal force to optional items as well as, say, additive items which must be ordered if funds are available.
115. Con-Chem Enterprises, supra, note 12.
116. Id.
117. International Signal and Control Corporation; Honeywell, Inc., Comp. Gen. B-192960, 78-2 CPD ¶416, (1978).
118. Id.

119. Ainslie Corporation, supra, note 12.
120. 51 Comp. Gen. 528 (1972).
121. Id.
122. ITT Federal Laboratories, 44 Comp. Gen. 581 (1965).
123. Id., at 583.
124. Cf. Gull Airborne Instruments Inc., Comp. Gen. B-176356, November 8, 1972 (Unpub.); Bristol Electronics, Inc., and E-Systems, Inc., Memcor Division, 54 Comp. Gen. 16 (1974); 51 Comp. Gen. 439 (1972).
125. ABL General Systems Corporation, 54 Comp. Gen. 476, 74-2 CPD ¶318 (1974).
126. Id., at 479; Cf. Sentinel Electronics, Inc., et al., 60 Comp. Gen. 202, 81-1 CPD ¶52 (1981).
127. Bristol Electronics, Inc., et al., supra, note 27; 51 Comp. Gen. 439 (1972).
128. Bristol Electronics, Inc., et al., supra, note 27.
129. Id.
130. Bristol Electronics, Inc., Comp. Gen. B-191449, 78-2 CPD ¶88 (1978).
131. R & R Inventory Service, Inc., Comp. Gen. B-181264, 74-2 CPD ¶163 (1974).
132. Comp. Gen. B-161208, August 8, 1967 (Unpub.); Comp. Gen. B-161928, August 8, 1967 (Unpub.); 49 Comp. Gen. 330 (1969); Comp. Gen. B-170254, April 23, 1971 (Unpub.); Comp. Gen. B-151910, September 17, 1963 (Unpub.); Comp. Gen. B-169309, May 22, 1970 (Unpub.).
133. Southeastern Services, Inc., and Worldwide Services, Inc., 55 Comp. Gen. 668, 77-1 CPD ¶390 (1977).
134. Safeguard Maintenance Corporation, Comp. Gen. B-204431, 82-1 CPD ¶236 (1982).
135. Id.
136. Edward B. Friel, Inc., 55 Comp. Gen. 231, 75-2 CPD ¶164 (1975); York Division, Borg-Warner Corporation, Comp. Gen. B-185945, 76-1 CPD ¶420 (1976); Reliable Trash Service, Comp. Gen. B-194760, 79-2 CPD ¶107 (1979); but cf. Solon Automated Services, Inc., Comp. Gen. B-206449.2, December 20, 1982, which held that the Army should not accept a mathematically unbalanced bid which was low only if all options were exercised and all prompt payment discounts were taken.

137. Edward B. Friel, Inc., supra, note 38.
138. York Division, etc, supra, note 38.
139. Edward B. Friel, Inc., supra, note 38.
140. Michael O'Connor, Inc., Free State Builders, Inc., Comp. Gen. B-183381, 76-2 CPD ¶8 (1976).
141. Id.
142. Id.; Edward B. Friel, Inc., supra, note 38.
143. Comp. Gen. B-161208, August 8, 1967 (Unpub.).
144. Id.
145. Mobilease Corporation, supra, note 9.
146. Id.
147. Comp. Gen. B-163828, June 18, 1968 (Unpub.); Comp. Gen. B-169838, June 2, 1971 (Unpub.) (even an application for P.L.85-804 relief will not make a "buy-in" per se illegal); Gadsby and Hannah, 50 Comp. Gen. 789 (1971).
148. See, e.g., DAR 1-311; NASAPR 1.311.
149. DAR 3-813 endeavors to further control this practice.
150. Comp. Gen. B-169824, June, 26 1970 (Unpub.); North American Laboratories of Ohio, Inc., 58 Comp. Gen. 724, 79-2 CPD ¶106 (1979).
151. North American Laboratories of Ohio, Inc., supra, note 52.
152. Id.
153. See Ch III, Sec A *infra*.
154. See also HR 4717 (96-729) which would have required ongoing cost comparisons for follow-on contract to avoid "buy-in" by a personal service contractor.
155. Comp. Gen. B-173276, August 19, 1971 (Unpub.).
156. Northrup Corporation, ASBCA No. 14763, 72-1 BCA ¶9344 (1972).
157. Id.
158. Dewey Electronics Corporation, ASBCA No. 17696, 76-2 BCA ¶12,146 (1976).
159. Consolidated Airborne Systems, Inc., ASBCA No. 20273, 78-1 BCA ¶13,068 (1978).

160. A.C. Electronics, Comp. Gen. B-185553, 76-1 CPD ¶295 (1976); EPSCO, Incorporated, Comp. Gen. B-187816, 75-2 CPD ¶338 (1975).
161. A.C. Electronics, supra, note 62; American Electronics Laboratories, Inc., Comp. Gen. B-198565, 80-1 CPD ¶325 (1980); Bristol Electronics, Inc, supra, note 27.
162. Allied Technology, Inc., Comp. Gen. B-185866, 76-2 CPD ¶34 (1976).
163. Id.
164. Management Information Technology, Comp. Gen. B-190453, 78-1 CPD ¶205 (1978).
165. Bristol Electronics, Inc., supra, note 27.
166. 39 Comp. Gen. 895 (1960).
167. Management Information Technology, supra, note 66.
168. Cole and Groner, 52 Comp. Gen. 372 (1972).
169. Id.
170. OMB Circular A-76, Section 9a(4), specifically encourages the use of options in service contracts.
171. House Reports 691-775, 96:1/2, 1979/1980, Vol. 12.
172. See, e.g., DAR 1-1505.
173. ABL General Systems Corporation, supra, note 28.
174. Id.
175. Keco Industries, Inc., 54 Comp. Gen. 967, 75-1 CPD ¶301 (1975).
176. Id.
177. OMB Circular A-94 (revised), March 27, 1972, 5 CFR §1310.51.
178. Id.
179. OMB Circular A-76.
180. But cf. 41 CFR §101-35.210(4)(b) pertaining to acquisition of automatic data processing equipment. "The present value of money factor as set forth in OMB Circular A-94 shall be included in comparative cost analysis."
181. Id.
182. Linolex Systems, Inc., and American Terminals & Communications, Inc., 53 Comp. Gen. 895, 74-1 CPD ¶296 (1974).

183. Id.
184. Id.
185. Id.
186. System Development Corporation and International Business Machines, Comp. Gen. B-204672, 82-1 CPD ¶218 (1982).
187. Id.
188. See also FPR 1-1.1507.
189. DAK 1-1505(d)(i); 41 Comp. Gen. 682 (1962); Comp. Gen. B-170913, August 5, 1970 (Unpub.); Cf. AF DAR Sup 1-1505(d).
190. DAR 1-1505(d)(2)(3)(4).
191. Victoreen Instrument Co., 36 Comp. Gen. 62 (1956).
192. Id.
193. Id. (quoting Western Union Telegraph Company v. Brown, executor of Lange, et. al., 253 U.S. 101 (1920)).
194. Inter-Alloys Corporation, Comp. Gen. B-182890, February 4, 1975, 75-1 CPD ¶79; Chemical Technology Inc., Comp. Gen. B-189660, April 25, 1978, 78-1 CPD ¶316; H.G. Peters & Company, Comp. Gen. B-183115, September 27, 1976, 76-2 CPD ¶284; C.G. Ashe Enterprises, 56 Comp. Gen. 397, 77-1 CPD ¶166 (1977); Transit Service, Inc., Comp. Gen. B-189820, August 22, 1977, 77-2 CPD ¶140.
195. H.G. Peters & Company, Id.; KET, Incorporated, 58 Comp. Gen. 38, 78-2 CPD ¶305 (1978); Bristol Electronic, Inc., Comp. Gen. B-193591, June 7, 1979, 79-1 CPD ¶403.
196. American Air Filter Co. - DLA Request for Reconsideration, 57 Comp. Gen. 567, 78-1 CPD ¶443 (1978).
197. FPR's at one time contained no provision comparable to DAR 1-1505(d).
198. KET, Incorporated, supra, note 8.
199. Id.
200. 41 Comp. Gen. 687 (1962), supra, note 2.
201. Id.
202. DAR 1-1505d(2).
203. Comp. Gen. B-164588, August 30, 1968 (Unpub.).
204. Bristol Electronics, Inc., supra, note 8.

205. Id.
206. Comp. Gen. B-172882, September 16, 1971 (Unpub.).
207. Id.
208. Id.
209. Shipshape Disposal, Inc., Comp. Gen. B-164588, August 30, 1968 (Unpub.).
210. Comp. Gen. B-173461, August 19, 1971 (Unpub.).
211. Comp. Gen. B-152508, May 1, 1964 (Unpub.).
212. Id.
213. Id.
214. KET, Incorporated, supra, note 8.
215. Id.
216. Comp. Gen. B-170913, November 17, 1970 (Unpub.).
217. Interscience Systems, Inc., 59 Comp. Gen. 68, 79-2 CPD ¶306 (1979).
218. Victoreen Instrument Co., supra, note 4; A.C. Electronics, supra, note 160; Butz Engineering Corp. v. U.S., 499 F.2d 619 (Ct. Cl. 1974).
219. International Telephone and Telegraph, ITT Defense Communications Division, 197 Ct. Cl. 11, 453 F.2d 1283 (1972).
220. Continental Electronics Corp., ASBCA Nos. 8677-8789, 1964 BCA ¶4287 (June 12, 1964).
221. General Dynamics Corporation, ASBCA No. 20882, 77-1 BCA ¶12,504 (April 13, 1977).
222. Chemical Technology Inc., ASBCA No. 21863, 80-2 BCA ¶14,728 (December 29, 1980).
223. Western Union Telegraph Co., supra, note 6.
224. See Williston, Contracts §61A at p199 (3rd ed. 1957).
225. Chrysler Motors Corporation, Comp. Gen. B-184865, 76-2 CPD ¶294, May 3, 1976.
226. Tidewater Protective Services, Inc., and Others, 56 Comp. Gen. 115, 76-2 CPD ¶462 (1976).
227. Amram Nowak Associates, Inc., 56 Comp. Gen. 448, 77-1 CPD ¶219 (1977).

228. The Ellinor Corporation, 54 Comp. Gen. 901, 75-1 CPD ¶254 (1975).
229. Northland Anthropological Research, Inc., 59 Comp. Gen. 80, 79-2 CPD ¶320 (1979).
230. Education Service District of Washington County, 60 Comp. Gen. 77, 80-2 CPD ¶379 (1980).
231. Dynalectron Corporation; Serv-Air, Inc., Comp. Gen. B-193604, July 24, 1979, 79-2 CPD ¶50.
232. Tymshare, Inc., Comp. Gen. B-186858, January 23, 1978, 78-1 CPD ¶56.
233. Vinnell Corporation, Comp. Gen. B-180557, October 8, 1974, 74-2 CPD ¶190; Informatics, Inc. - Reconsideration, 56 Comp. Gen. 663, 77-1 CPD ¶383 (1977); Gould, Inc., Comp. Gen. B-190787, August 31, 1978, 78-2 CPD ¶158.
234. Comp. Gen. B-176352, October 5, 1972 (Unpub.); Comp. Gen. B-166499, May 29, 1969 (Unpub.).
235. C.G. Ashe Enterprises, supra, note 7.
236. A.C. Electronics, Inc., supra, note 31; Raven Industries, Inc., Comp. Gen. B-185052, February 11, 1976, 76-1 CPD ¶90; Modern Moving and Storage, Comp. Gen. B-182420(2), January 16, 1975, 75-1 CPD ¶26.
237. C.G. Ashe Enterprises, supra, note 7.
238. Industrial Maintenance Services Inc., Comp. Gen. B-189958, September 15, 1977, 77-2 CPD ¶195,. But cf. Chemical Technology, Inc., Comp. Gen. B-190225, May 5, 1978, 78-1 CPD ¶342, "... GAO will not consider whether contracting agency should have exercised an option ... however in the present case, the question is not whether the Air Force should have exercised the option, but whether the subsequent procurement was in derogation of the option already exercised".
239. Westinghouse Electric Corporation, 57 Comp. Gen. 328, 78-1 CPD ¶181 (1978).
240. Id., at 331.
241. Id., at 332.
242. Manloading & Management Associates, Inc., v. U.S., 198 Ct. Cl. 628, 461 F.2d 1299 (1972); but cf., Fox International, Inc., Comp. Gen. B-181675, March 3, 1975, 75-1 CPD ¶126. However Fox can be distinguished on the basis that the option provision there in question was an option to negotiate (see Ch III, D) and the Government's expression of intent to negotiate under the option provision was not the equivalent of an expression of intent to exercise the option itself. Cf., Ace Electronics Assoc., Inc., ASBCA No. 11298, 66-2 BCA ¶5744, August 3, 1966; Ronald K. Bradley d/b/a Alaska Hospitality, 53 Comp. Gen. 902, 74-1 CPD ¶297 (1974) "Hospitality contends it was given verbal assurance by (Government)

representatives that the lease would be extended for 10 years. The (Government) does not admit that any such assurances were given in connection with the concession lease. In any event, since the extension provisions of the lease have not been modified in writing, any oral statement purporting to alter those provisions would be ineffective. Corbin in Contracts, Section 573."; Comp. Gen. B-151759, November 13, 1963 (Unpub.).

243. Id., 198 Ct. Cl. at 631, 632.

244. Id., 198 Ct. Cl. at 632.

245. Id., 198 Ct. Cl. at 637.

246. Central Navigation and Trading Co., S.A., ASBCA No. 23909, 80-2 BCA ¶14,497, May 20, 1980.

247. Central Navigation and Trading Co., Comp. Gen. B-189435, January 5, 1978, 78-1 CPD ¶6; Request for Reconsideration, Comp. Gen. B-189435, December 5, 1978, 78-2 CPD ¶386.

248. Central Navigation and Trading Co., SUPRA, note 59.

249. See Peter Foskett, PSBCA No. 387, ___ BCA ___ (1981); Maintenance Engineers, ASBCA No. 16985, 74-2 BCA ¶10,912, October 25, 1974 held that absent a provision for price adjustment for failing to exercise an option, the ASBCA was without jurisdiction to decide the issue. The Disputes clause did not provide a basis for ASBCA jurisdiction under the rule announced in United States v. Utah Construction and Mining Co., 384 U.S. 394 (1966).

250. DAR 1-1505(a); FPR 1-1.1507(a), (f); NASAPR 1.1505(a); DOEPR 9-1.5304(a); Dynamics Corporation of America as Successor in Interest to International Ferromont, Inc., v. U.S., 182 Ct. Cl. 62, 389 F.2d 424 (1968); General Dynamics Corporation, supra, note 34.

251. DAR 1-1505(a).

252. Thanet Corporation, 591 F.2d 629 (Ct. Cl. 1979).

253. Id.

254. Mills Manufacturing Corporation, ASBCA No. 10476, 66-1 BCA ¶5450 (1966).

255. Id.

256. Id.

257. Id.; Cf. Chemical Technology, Inc., Comp. Gen. B-190225, May 5, 1978, 78-1 CPD ¶342.

258. Universal American Enterprises, Inc., ASBCA No. 22562, 81-1 BCA ¶14,942 (1981).

259. Id.
260. Id.
261. Chemical Technology, Inc., ASBCA No. 21863, 80-2 BCA ¶14,728 (1980).
262. Id., but cf. Epsy Manufacturing Co. Inc., ASBCA No. 925, October 31, 1952.
263. Space-Age Engineering Inc., ASBCA No. 22901, 78-2 BCA ¶13,543 (1978).
264. Id.
265. Id.
266. International Telephone and Telegraph, et. v. U.S., supra, note 32.
267. Id.
268. Comp. Gen. B-176386, October 24, 1972 (Unpub.).
269. Id.
270. Id.
271. Id.
272. Id. The intention of the parties was apparently derived from the contents of a letter from the contractor to the Government which stated, according to the GAO, that "this modification did not affect the Government's right to exercise the option according to the terms of the original contract." (emphasis added). It would seem that this letter itself is subject to at least two interpretations, one of which would be merely that the contractor is reaffirming its understanding of the option clause as accelerating the exercise period where the basic contract is accelerated. The opinion however does not indicate that this avenue of inquiry was pursued. Had it been, contra proferendum would likely have become the applicable rule of law, hence option exercise would have thereby been untimely.
273. Keco Industries, Inc., ASBCA No. 16645, 73-2 BCA ¶10,056, (1973).
274. Id.
275. Id.
276. Id.
277. Id.; Cf. Lear Siegler, Inc., ASBCA No. 12164, 69-1 BCA ¶7563 (1969).
278. Conrac Corporation, ASBCA No. 22922, 78-2 BCA ¶13,449, (1978); Fort Howard Paper Company, ASBCA No. 20284, 78-1 BCA ¶13,027, (1978); (distinguishing Keco.); Cf. Damascus Hosiery Mills, Inc., ASBCA No. 18776, 74-2 BCA ¶10,961, (1974), where the Board held that an

acceleration of the delivery schedule did not constitute an "adjustment" as that term was used in the option clause. Thus the Government was entitled to exercise the option under the original contract schedule.

279. [1980] 80-4 Briefing Papes (Federal Publications Inc.) 10.

280. Lear Siegler, Inc., ASBCA No. 12164, 69-1 BCA ¶7563 (1969).

281. Id.

282. Id.

283. Id.

284. Dynamics Corporation of America, as Successor in Interest to International Ferment, Inc. v. U.S., supra, note 64; IA Corbin on Contracts §264 (1963).

285. Id.

286. Id.

287. Id.

288. International Telephone and Telegraph, etc. v. U.S., supra, note 32.

289. J.E.T.S., Inc., ASBCA No. 26135, _____ BCA _____, August 4, 1982.

290. Id.

291. See also Skip Kirchdorfer, Inc, ASBCA No. _____, _____ BCA _____ (1982); Ampex Corporation, GSECA No. 5913, 82-1 BCA ¶15,783 (1982).

292. E. Walters & Company, Inc. v. U.S., 576 F.2d 362, (Ct. Cl. 1978).

293. Accord, Copco Steel and Engineering Co. v. U.S., 169 Ct. Cl. 601 (1965).

294. U.S. v. Swift & Co., 207 U.S. 124 (1925).

295. Fox International, Inc., supra, note 55.

296. Id.

297. Id.

298. Cummings & Sellers, 43 Comp. Gen. 451 (1963).

299. Fox International, Inc., supra, note 55.

300. Id.

301. Cummings & Sellers, supra, note 106.

302. Mills Manufacturing Corporation, supra, note 68.
303. Fox International, Inc., supra, note 55.
304. Cummings & Sellers, supra, note 106, Fox International, Inc., supra, note 55.
305. Epsey Manufacturing Co., Inc., supra, note 76.
306. RCA Service Company, ASBCA No. 11225, 66-2 BCA ¶5844 (1966).
307. Id.
308. U.S. v. Swift & Co., supra, note 102.
309. Cf. Dynamics Corporation of America, etc. v. U.S., supra, note 64.
310. See, e.g., DAR 7-1101.
311. Federal Electric Corporation, supra, note 22.
312. Comp. Gen. B-121926, March 21, 1955 (Unpub.); Willard Southerland & Co. v. U.S., 262 U.S. 489 (1923); William C. Atwater & Co., Inc., v U.S., 262 U.S. 495 (1923), Tennessee Soap Company, 130 Ct. Cl. 154 (1954); Federal Electric Corporation v U.S., 202 Ct. Cl. 1028 (1973).
313. Asiatic Petroleum Company, ASBCA No. 17765, 74-2 BCA ¶10,833, (1974); DAR 3-409.3.
314. Sanz School of Languages, ASBCA No. 4257, 1964 BCA ¶4257 (1964); Aetna Plywood & Veneer Co., ASBCA No. 2526 (1955).
315. Charles Bainbridge Inc., ASBCA No. 19949, 75-2 BCA ¶11,414 (1975).
316. Id.; But cf. Toke Cleaners, IBCA 1008-10-73, 74-1 BCA ¶10,633 (1974) Where Government failed to order minimum quantity and contract did not have Termination for Convenience clause. Contractor not entitled to relief.
317. Albano Cleaners, 197 Ct. Cl. 450 (1972). This appears to have been a requirements contract committing the Government to give all cleaning work of a certian type within a certain geographical zone to Albano. The Government cancelled Alano's contract after another bidder lodged a protest. The Government argued that it had placed more than the minimum orders with Albano, hence cancellation was appropriate. The Court of Claims held that Termination for Convenience was the appropriate termination format. It could be argued that this principle should apply equally to indefinite quantity contracts with a fixed period of performance, such as the painting contract in Bainbridge, supra, note 123. Clearly, absent a requirements contract, the Government would be free not to place work with a particular contractor once the minimum was met, but it should not be free to cancel such a contract.
318. Radionics, Inc., ASBCA No. 20796, 77-1 BCA ¶12,448 (1977).

319. Id.

320. Id.

321. Federal Electric Corporation, supra, note 119.

322. Id.

323. Gray Advertising, Inc., Comp. Gen. B-184825, 76-1 CPD ¶325 (1976).

324. A.C. Ball Company, ASECA No. 19375, 75-1 BCA ¶11,298 (1975); aff'd
at 75-2 BCA ¶11,500 (1975).

325. Id.

9. LIFE CYCLE COST EVALUATION

The offeror is required to submit all pricing data in the format indicated in Sections L and B.

a. General.

(1) Life cycle cost evaluation will consist of purchase, lease and lease with option to purchase or any other legally acceptable plan.

(2) For the purpose of the RFP, the terms "lease" and "rental" are used interchangeably.

(3) For cost evaluation purposes only, prompt payment discounts will be considered in the cost evaluation only if the minimum period for the offered discount is 30 days or more.

(4) Subsequent to best and final offers and prior to contract award, each offeror will be invited to review the Government-developed cost summaries of the offeror's own proposal and prior to departure will certify that the cost summaries were reviewed. This review in no way constitutes reopening of negotiations.

b. Cost Model. For the purposes of cost evaluation only, the cost evaluation model is described completely in the following subparagraph.

(1) Contract Life. The contract life commences with the assumed date of contract award and ends 96 months later. For this RFP, the following assumptions are made:

Assumed Contract Award Date: 1 November 1980

Last Day of Contract Life: 31 October 1988

Contract Life: 96 months

Equipment Installation Dates:

Initial - May 1981 (Contract Month 7)

Comm. Expansion - Nov, 1982 (Contract Month 25)

IAS Expansion -

<u>Increment</u>	<u>Contract Month</u>	<u>Quantity</u>
I01	19	1 BIL
I02	31	1 BIL
I03	43	1 BIL
I04	55	1 BIL
I05	67	1 BIL
I06	79	1 BIL
I07	91	1 BIL
IR1	79	1 BIL

Refer to paragraph 9.d for a graphic depiction of the relationship between contract months and system life months.

(2) Operational Use. The system will be considered to operate 24 hours a day, seven days a week. Extra use charges, if any will be

evaluated assuming the equipment will operate 600 hours per month.

(3) On-Site Maintenance. Charges for the 18 Hr. on-site coverage (0000-1800) Monday through Friday plus OPPM charges as explained in paragraph (4) below will be the only charges for maintenance in the cost evaluation. All maintenance charges will be applied beginning in the assumed month of installation. For purchase plans see also 9.b(5).

(4) On-Call Maintenance.

(a) The evaluation of on-call maintenance outside the principal period of maintenance (OPPM) assumes there will be one call per month. If on-call charges vary by day of the week, the following formula will be used to calculate the average man-hours price to be used:

$$\text{Average Man-Hour Price} = \frac{3}{5} \text{ weekday rate} + \frac{1}{5} \text{ Saturday rate} + \frac{1}{5} \text{ Sunday/holiday rate}$$

(b) For the purpose of evaluating unscheduled, two-hour response, on-call maintenance, a two man-hour charge per call will be used subject to the following conditions:

1 If the minimum charge per call is greater than a two man-hour charge per call for any plan, the minimum charge per call will be used for the plan.

2 If the maximum charge per call is less than a two man-hour charge per call for any plan, the maximum charge per call will be used for the plan.

(5) Purchase Warranty. In evaluating purchase plans the 90-day free maintenance warranty will be applied such that no maintenance charges will be assessed during the first 90 days after the assumed installation date of any equipment purchased outright.

(6) Data. The charges for data (including training materials) will be applied as follows unless offered otherwise:

<u>CDRL</u> <u>SEQUENCE NO.</u>	<u>CONTRACT</u> <u>MONTH</u>
A001	2
A002	7
A003	3
A004	96
A005	6

(7) Systems Analyst Support. The charges for one Operating System (OS) Software Analyst and one Teleprocessing/Data Communications (T/DC) Analyst will begin in Contract Month 3 for 94 months. Charges for the other OS and T/DC Analysts will begin in Contract Month 3 for twelve months. Charges for the AMIS System Analyst will begin in Contract Month 2 for 12 months.

(8) Training. The charges for training (excluding training materials) will be costed as follows unless stated otherwise:

<u>Type</u>	<u>No. of Classes</u>	<u>Contract Month</u>
Management Orientation	2	2,3
Computer Operations	3	6,7,7
Application Programmer	4	2,4,6,7
System Programmer	4	4,4,7,7
System Analyst	2	2,2

All classes will be evaluated as being conducted at WPAFB, Ohio, except the computer operator's course, which will be evaluated as being conducted at the Contractor's facility.

(9) Software. The charges for software will be applied beginning in the assumed month of installation (Contract Month 7) unless stated otherwise.

(10) Pre-Installation Test Facility. The charge for 350 wall clock hours of pre-installation test time will be applied at the rate of 70 hours/month in Contract Months 2 through 6 unless stated otherwise.

(11) Software Conversion. The charges for the software conversion efforts will be applied in Contract Month 7 unless stated otherwise.

(12) Utilities. The assessed charge for utilities will include the power required to operate the offeror's proposed equipment and the necessary cooling equipment. The utility charge per month will be calculated according to the following formula:

$$\text{Charge/Month} = (H)(W1)(.0304)(.8) + (H)(W2)(.0304)$$

Where:

H - Available use hours, which is set at 720 per month.

W1 - Total kilowatts (KW) required to power the installed equipment, including expansion equipment, when applicable (From Table L-1).

W2 - Total kilowatts required to power the air conditioning and chilled water equipment. This cost will be based upon data furnished in Table L-1. For this cost evaluation, 10,000 BTU = 1KW.

.8 - Utilization factor for equipment. (This factor was included in the KW to BTU conversion for other equipment.)

(13) The residual value of the equipment will be considered to be zero (0) for cost evaluation purposes.

c. Economic Analysis.

(1) Life cycle present value cost will be the economic basis for contract award. An economic analysis will be made to determine the present value of monies for the expected cost of each offered item for the contract life. An annual percentage rate of 10% will be used in discounting the expected cost. All costs will be discounted on the assumed contract award date on a monthly basis. The present value factor utilized for each month will be the factor for the month in which the costs will be incurred. For the purposes of present value factor application, an obligation which is payable at some deferred date in accordance with proposed terms and conditions, other than normal billing practices as described in Section G, will be taken to be incurred on that deferred date. Any offeror-identified cost or price for which the Government is contractually obligated, but which is due beyond the termination of the contract, will be assumed to be payable in the last contract month. It is not a requirement of this solicitation for the offerors to apply present value to costs in their proposals. The formula below and the Present Value Table are furnished for the offeror's information only.

$$PVCOST = \sum_{i=m}^n (PVF_i) (COST_i)$$

Where:

- PVCOST - Computed Present Value Cost
- PVF_i - Present Value Factor for Month i
- COST_i - Cost Value for Month i
- m - Beginning month of contract life
- n - Ending month of contract life

(2) The following table represents the monthly present value factors that will be used for this price evaluation:

FACTORS FOR PRESENT VALUE

<u>Month</u>	<u>Factor</u>	<u>Month</u>	<u>Factor</u>	<u>Month</u>	<u>Factor</u>
1	.992089	35	.757306	69	.578085
2	.984240	36	.751315	70	.573512
3	.976454	37	.745371	71	.568975
4	.968729	38	.739474	72	.564474
5	.961066	39	.733624	73	.560008
6	.953463	40	.727821	74	.555578
7	.945921	41	.722063	75	.551183
8	.938436	42	.716351	76	.546822
9	.931012	43	.710683	77	.542496
10	.923647	44	.705061	78	.538205
11	.916340	45	.699483	79	.533947
12	.909091	46	.693950	80	.529723
13	.901899	46	.688460	81	.525532
14	.894764	48	.683013	82	.521375
15	.887686	49	.677610	83	.517250
16	.880663	50	.672249	84	.513158
17	.873696	51	.666931	85	.509098
18	.886781	52	.661655	86	.505017
19	.859927	53	.656421	87	.501075
20	.853124	54	.651228	88	.497111
21	.846375	55	.646076	89	.493179
22	.839679	56	.640965	90	.489277
23	.833036	57	.635894	91	.485406
24	.826446	58	.630863	92	.481566
25	.819908	59	.625873	93	.477757
26	.813422	60	.620921	94	.473977
27	.806987	61	.616009	95	.470227
28	.880603	62	.611136	96	.466507
29	.794269	63	.606301		
30	.787986	64	.601505		
31	.781752	65	.596746		
32	.775567	66	.592025		
33	.769432	67	.589342		
34	.763345	68	.582695		