

Beware Of GSA's Price Reductions Clause

Law360, New York (March 1, 2011) -- On Jan. 13, 2011, the U.S. Department of Justice announced that it had reached a \$6.25 million settlement with Fastenal Company, a national hardware store distributor, following an investigation of alleged false claims in connection with a General Services Administration (GSA) contract.

The alleged false claims related to a 2000 GSA multiple award schedules (MAS) contract that Fastenal had entered to sell its hardware products to government agencies using GSA MAS.

The subject contract terminated in 2005. In 2006, a post-contract audit completed by the GSA Office of Inspector General (OIG) indicated Fastenal had provided better discounts to its identified nongovernmental customers than it had to its GSA MAS customers, which, if true, was a violation of the price reductions clause (PRC) present in every GSA MAS contract.

Based on its audit and investigation, GSA OIG referred the matter to the DOJ because it believed Fastenal knowingly failed to meet its GSA MAS contractual obligations: (1) to provide the GSA with current, complete and accurate information about its commercial sales practices, including discounts afforded to other customers; and (2) to comply with the contract's PRC.

As a result of these alleged contractual violations, as well as an allegation that Fastenal improperly assessed delivery and sales tax charges on government sales, the DOJ informed Fastenal in 2010 that it would initiate action under the False Claims Act if Fastenal did not pay \$9.5 million in restitution.[1] After about six months of negotiations, Fastenal agreed to pay \$6.25 million to resolve all allegations that had been made against it.[2]

Beyond the stiff penalties a company can face if it is accused of making false claims in a traditional government contract action, this matter demonstrates the false claims risks present in the GSA MAS program. To better understand the costs and benefits associated with this program, one must first examine the underlying regulations that allow for its use.

Federal Supply Schedules

GSA MAS implementation is governed by Federal Acquisition Regulation (FAR) Part 8.4, Federal Supply Schedules. As stated in FAR Part 8.4, GSA offers an online shopping service called “GSA Advantage!” Through GSA Advantage!, agencies can place orders directly with GSA MAS contractors and pay for them using the government-wide commercial purchase card.

Orders made using GSA MAS do not require the use of the competitive evaluation processes found in FAR Parts 13, 14 or 15, as such deliveries “are considered to be issued using full and open competition.”[3] As such, agencies frequently utilize GSA MAS to make a quick, hassle-free purchase.

Given the lack of procedural requirements, it is not surprising that the GSA MAS program is the federal government’s largest interagency contracting program. In fiscal year 2010, there were 18,396 GSA MAS contract actions totaling approximately \$39 billion.[4] So what must an agency do before making a GSA MAS purchase?

For most purchases of \$3,000 or less, an agency simply can make a purchase using GSA MAS in much the same way a consumer orders from an online catalog. The only stipulation in FAR Part 8.4 is that the “ordering activity should attempt to distribute orders among contractors.”[5]

For purchases above \$3,000 but less than an item’s maximum order threshold[6], a few additional requirements apply. The maximum order threshold does not have a set dollar value, as it varies depending on the special item number (SIN) of the item being procured. For example, the maximum order threshold for SIN C 1365, Military Chemical Agents, is \$100,000.

An agency procuring military chemical agents valued between \$3,000 and \$100,000 must survey the products and prices of at least three GSA MAS contractors to determine which one offers the best value. The agency only must consider price when making its best value determination, but it also may look at other factors, such as past performance, warranty considerations, and maintenance availability.[7]

Thus, it is perfectly permissible for an agency to review the prices of three companies selling a military chemical agent on GSA MAS, and buy \$90,000 of the agent from the cheapest seller (or even the most expensive seller if other best value factors are considered).

Finally, for procurements exceeding the maximum order threshold, the agency is required to seek a price reduction. So if an agency wants to procure military chemical agents valued at \$200,000 using GSA MAS, it must determine which MAS contractors offer the best value and negotiate with these contractors in an attempt to get a price reduction before making a final best value decision. Only the negotiation is required, and an agency may award to the contractor it determines offers the best value even if that contractor offered no price reduction after the negotiation.[8]

There are a few additional requirements beyond those detailed above when an agency is procuring services that are priced on an hourly basis. For example, SIN 132-51, Information Technology (IT) Professional Services, is normally charged on a hourly rate basis and its maximum order threshold is \$500,000.

If an agency wants to procure between \$3,000 and \$500,000 of IT professional services using GSA MAS, it must send a statement of work and its evaluation criteria to at least three MAS contractors that offer IT services that will meet the agency's needs and request the submission of firm-fixed price quotations.[9]

Then, after making its best value determination, the agency must document, among other things, the evaluation methodology used, the rationale for any tradeoffs employed in making the determination, its price reasonableness determination, and the price paid.

If the above procurement action were to exceed \$500,000, the agency cannot strictly limit its consideration to only three contractors if other contractors could meet the agency's needs and it also must engage in price reduction negotiations, whether successful or not, before making a final best value determination.[10]

Price Negotiations and the Price Reductions Clause

Since FAR Part 8.4 has so few evaluation and best value requirements[11], GSA generally insists a contractor list an item at or below its lowest available price to an identified category of customers before accepting the item for inclusion on GSA MAS. This process usually begins with a contractor's submission of data on the item's customers, prices, sales volume, discounts, concessions, etc. using GSA's Commercial Sales Practices (CSP) form.

A GSA price negotiator then reviews the CSP information and "seek[s] to obtain the offeror's best price (the best price given to the most favored customer)" with the understanding that "the terms and conditions of commercial sales vary and there may be legitimate reasons why the best price is not achieved." [12] After negotiations have been completed and a price has been set, GSA enforces its "most favored customer" status through the PRC.

The PRC details a contractor's required actions with regard to its listing on GSA MAS. It begins with a statement that the CO and the contractor will agree before contract award on the customer or category of customers that will be the basis of award — also called the "the identified customer" — and GSA's price or discount relationship to this identified customer. It next states that if this relationship is disturbed after contract award by the contractor reducing the pricing or increasing the discounts applicable to the identified customer, such an action "shall constitute a price reduction." [13]

The PRC requires a contractor to report to the CO "all price reductions" provided to the identified customer within 15 calendar days of the reductions' effective date, including "an explanation of the conditions under which the reductions were made." [14]

Since the word “all” is used, this includes price reductions that impact identified commercial customers, even if the price reduction does not impact the government’s standing as the recipient of the greatest price reduction. The PRC states the price reduction relationship between the identified commercial customer and the government “shall be maintained throughout the contract period” and “[a]ny change” to this relationship is a price reduction.[15]

In fact, the General Services Administration Manual (GSAM) makes this point very clear in its instructions to contract negotiators:

“If a change occurs in the contractor’s commercial pricing or discount arrangement applicable to the identified commercial customer (or category of customers) that results in a less advantageous relationship between the eligible ordering activities and this customer or category of customers, the change constitutes a ‘price reduction.’ ... Make sure that the contractor understands the requirements of [the PRC] and agrees to report to you all price reductions as provided for in the clause.”[16]

If a price reduction is extended to an identified customer, the PRC requires the contractor to offer GSA the same price reduction for the same time period and with the same effective date. This includes post-contract award revisions that are more favorable to identified customers, such as reduced catalog prices, more favorable discount terms, changes to terms and conditions, and special customer discounts.[17]

If the price reduction is accepted by the government, the underlying contract will be modified to reflect the price reduction.[18] The only exceptions to this price reduction requirement are: (1) sales specifically identified and excepted from PRC coverage during the CSP and price negotiation process; (2) sales “[t]o commercial customers under firm, fixed-price definite quantity contracts with specified delivery in excess of the maximum order threshold specified in [the MAS] contract;” and (3) when an error in quotation or billing occurs and the CO is provided adequate documentation of this error.[19]

Other GSA Cases

As the Fastenal matter demonstrates, a contractor’s failure to provide GSA with current, complete and accurate information about its commercial sales practices during the life of an item’s GSA MAS listing and to offer GSA discounted pricing as required under the PRC can jeopardize the contractor’s financial well being. This is further underscored by the fact the Fastenal case is not unique.

In 2009 and 2010, GSA OIG reviewed 200 contracts valued at approximately \$25 billion, and it settled 23 FCA cases valued at over \$400 million.[20]

The biggest of these settlements occurred in 2009 when the DOJ reached a \$128 million FCA settlement with NetApp Inc. (NetApp) based on information it had been provided by a former NetApp employee indicating the company had knowingly failed to meet its GSA MAS contractual obligations to provide GSA with current, complete and accurate information about its commercial sales practices and had knowingly made false statements to GSA about its sales practices and discounts.

In that case, the former employee, an FCA relator who initiated the qui tam action under the civil FCA,[21] received \$19.2 million as his share of the government's recovery.[22]

A contractor's concerns should not be limited to the FCA. The PRC is a contractual obligation, and, as such, a contractor's failure to abide by its terms can result in a claim initiated by the government for discounts it believes it should have received.

In Invacare Corp.,[23] the contractor disclosed to the government the discount it was offering a commercial customer, but argued it was not required to offer the government the same discount because that customer had agreed to buy 90 percent of its requirements from the contractor and therefore was a different category of customer than the contract's identified customer.

This argument ultimately failed, and the contractor was ordered to compensate the government for not providing it the discount amount the contract required.

Recommended Preventative Actions

If a contractor is contemplating entering a GSA MAS contract, it should consider employing the following measures to ensure it does not later face allegations of false claims or contract violations:

- Provide GSA complete CSP data that lists all unique sales practices and atypical customers that may be excepted from PRC coverage.
- Implement a database that tracks all subject item discounts and concessions that may be offered to GSA MAS identified customers.
- Ensure all sales personnel input accurate and timely data into this database and monitor it on a daily basis.
- Ensure approval authority of any discount or concession that may impact GSA's most favored customer status is limited to high-level employees that have a thorough understanding of PRC requirements.
- Implement a system that ensures prompt CO notification of any price reduction that has occurred, even if the contractor does not believe the price reduction was offered to an identified customer, as well as notification of any quotation or billing errors that resulted in an identified customer receiving a greater discount than was intended.

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[1] See Fastenal Form 8-K filing for the period ending January 13, 2011, available at: <http://files.shareholder.com/downloads/FAST/0x0xS1171843-11-103/815556/filing.pdf> ("As of June 30,

2010, the DOJ had offered to resolve this matter for a payment by us of \$9.5 million and we had offered \$750 thousand, which amount we had accrued. During the third quarter of 2010 we continued our discussions with the DOJ. The DOJ has currently offered to resolve this matter for \$8.5 million and we have offered \$2.75 million, which amount we have accrued as of September 30, 2010. The timing and outcome of these discussions are uncertain and could include settlement or civil litigation by the DOJ to recover, among other amounts, treble damages and penalties under the False Claims Act.”)

[2] The settlement also resolved allegations that Fastenal violated the Trade Agreements Act when it knowingly sold products to the United States that were manufactured in countries that do not have trade agreements with the United States, e.g., China. (See GSA OIG’s “All OIG News” available at: <http://www.gsaig.gov/allnews.cfm>). The Trade Agreements Act clause, FAR Subpart 52.225-5, is currently required in all contracts valued at \$203,000 or more, if the acquisition is covered by the World Trade Organization Agreement on Government Procurement (WTO GPA), and it basically states that the Government may only procure “U.S.-made or designated country end products.”

[3] FAR Subpart 8.404(a).

[4] Statement of Hon. Brian D. Miller, Inspector General, General Services Administration Before Senate Committee on Homeland Security and Governmental Affairs, Ad Hoc Subcommittee on Contracting Oversight, February 1, 2011, available at: <http://hsgac.senate.gov/public/index.cfm?FuseAction=Subcommittees.ContractingOversight>.

[5] Id. at Subpart 8.405-2(c)(1).

[6] An item’s maximum order threshold “represents the point where, given the dollar value of the potential order, the ordering activity shall seek a price reduction.” Id. at Subpart 8.405-1(d).

[7] Id. at Subpart 8.405-1(c).

[8] Id. at Subpart 8.405-1(d).

[9] Id. at Subpart 8.405-2(c)(2).

[10] Id. at Subpart 8.405-2(c)(3).

[11] It should be noted that some agencies impose additional requirements on contracting officers (COs) making GSA MAS purchases. For example, among other requirements, the Department of Defense requires COs to notify as “many schedule contractors as practicable ... to reasonably ensure that offers will be received from at least three contractors that can fulfill the requirements” of a GSA MAS order exceeding \$150,000. See DFARS Subpart 208.405-70.

[12] GSAM Subpart 538.270.

[13] Id. at Subpart 552.238-75(a).

[14] Id. at Subpart 552.238-75(b) and (f).

[15] Id. at Subpart 552.238-75(a)-(b).

[16] Id. at Subpart 538.272.

[17] Id. at Subpart 552.238-75(c).

[18] Id. at Subpart 552.238-75(g).

[19] Id. at Subpart 552.238-75(d).

[20] See Statement cited at note 4 supra.

[21] 31 U.S.C. § 3729 et seq.

[22] See Department of Justice, Office of Public Affairs, Press Release (Apr. 15, 2009), available at: <http://www.justice.gov/opa/pr/2009/April/09-civ-353.html>.

[23] VABCA No. 6574, 02-2 BCA ¶ 32,040 (Oct. 3, 2002).

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