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U.S. Department of Energy
Office of Inspector General

August 1995



Report on

Inspection of Westinghouse Savannah River Company Fees for Managing and Operating the Savannah River Site

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United States Government

Department of Energy

memorandum

DATE: August 3, 1995

REPLY TO
ATTN OF: IG-1SUBJECT: INFORMATION: Report on "Inspection of Westinghouse Savannah River Company Fees for Managing and Operating the Savannah River Site"

TO: The Secretary

BACKGROUND:

During the first five years of its contract with the Department of Energy, Westinghouse Savannah River Company was paid over \$130 million in fees to manage and operate the Savannah River Site. Fees paid to Westinghouse steadily increased over the five year period. For example, fees paid for the last six months of this five year period were over three times as large as fees paid for the first six months. The purpose of this inspection was to review the Department's annual negotiation of total available fees with Westinghouse, and to examine the reasons for the growth in fees over this five year period. The report is being sent to inform you of our findings and recommendations.

DISCUSSION:

Our review disclosed that, after Fiscal Year 1989, the Department used an increasing number of fee bases in calculating Westinghouse Savannah River Company's fixed-fee-equivalents from the maximum fee schedules within the Department of Energy Acquisition Regulation. Two fee bases were used in the 1989 calculation, and eight were used in the 1994 calculation. These increases in the number of fee bases resulted in significantly higher fixed-fee-equivalents being calculated from the maximum fee schedules.

We found that the Department had significantly increased the percentage of the dollar value of subcontracts being placed in Westinghouse's fee bases for fee calculation purposes. In Fiscal Year 1989, 50 percent of the value of Westinghouse's subcontracts was included in the fee bases; by Fiscal Year 1993, 100 percent of the value of a portion of work performed under one subcontract was included in the fee bases. Since the subcontractor was also receiving a fee for this portion of work, the Department was paying two full fees for the same work.

We found that the Department had effectively increased Westinghouse's fixed-fee-equivalents by approximately \$3 million in both Fiscal Year 1993 and 1994 to, in large part, fund an "unallowable" employee incentive compensation program.

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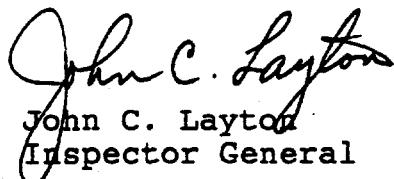


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We found that Westinghouse's total paid fees for the five year period increased significantly over what they would have been had the terms resulting from the original competitive negotiations been maintained. Using actual performance scores, we estimated that Westinghouse would have received approximately \$70.9 million in total fees under the terms initially negotiated, or some \$59.7 million less than the \$130,621,000 actually received during this five year period.

We recommended that the Deputy Assistant Secretary for Procurement and Assistance Management require that changes in either the number or composition of fee bases used in calculating fees from the maximum fee schedules be submitted to the Department's Procurement Executive for approval. We recommended that a standard for weighting the dollar value of subcontracts in fee bases be established, along with a requirement for justification and approval when the standard is exceeded. We also recommended that negotiated fixed-fee-equivalents not include either direct or indirect funding for "unallowable" incentive compensation programs. We further recommended that initially negotiated total available fee, negotiated fixed-fee-equivalents, and the relationship of fixed-fee-equivalents to the maximum fee schedules, be used to benchmark total available fees negotiated in subsequent fee periods.

In commenting on our report, management concurred with the recommendations and identified corrective actions.



John C. Layton
Inspector General

Attachment

cc: Deputy Secretary
Under Secretary
Associate Deputy Secretary for Field Management
Deputy Assistant Secretary for Procurement and
Assistance Management
Manager, Savannah River Operations Office

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

REPORT ON INSPECTION OF
WESTINGHOUSE SAVANNAH RIVER COMPANY FEES
FOR MANAGING AND OPERATING THE SAVANNAH RIVER SITE

Report No.: DOE/IG-0377
Date Issued: August 3, 1995

Office of Inspections
Washington, DC 20585

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MASTER

REPORT ON INSPECTION OF
WESTINGHOUSE SAVANNAH RIVER COMPANY FEES
FOR MANAGING AND OPERATING THE SAVANNAH RIVER SITE

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U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL
OFFICE OF INSPECTIONS
WASHINGTON, DC 20585

REPORT ON INSPECTION OF
WESTINGHOUSE SAVANNAH RIVER COMPANY FEES
FOR MANAGING AND OPERATING THE SAVANNAH RIVER SITE

I. PURPOSE AND OBJECTIVES

The purpose of this inspection was to review the Department of Energy's (DOE) annual negotiation of total available fees with the Westinghouse Savannah River Company (WSRC) under Contract No. DE-AC09-89SR18035. The specific objectives of this inspection were to: (1) determine whether the negotiation process for total available fees had been administered in conformance with the requirements of the Department of Energy Acquisition Regulation (DEAR), to include documentation, approvals, and timeliness; (2) determine whether the negotiated total available fees conformed with the Department's fee policies, as stated in the DEAR; (3) assess the adequacy of justifications for negotiated total available fees; and (4) evaluate the overall results and effectiveness of the process for negotiating total available fees.

II. SCOPE AND METHODOLOGY

This inspection covered the initial negotiation of total available fees in 1988, and all subsequent negotiations through Fiscal Year (FY) 1994. In conducting this inspection, the inspectors examined how WSRC's total available fees were established each year, including the amount and composition of fees. The inspectors did not address performance evaluation plans, nor the Government's process for evaluating WSRC's performance and determining actual fees paid to WSRC. They did, however, analyze historical performance scores and fees paid to WSRC.

In the course of the inspection, interviews were conducted with procurement officials in the Department's Office of Procurement and Assistance Management, and at the Savannah

River Operations Office (SR). Reviews were also made of both the Department of Energy Acquisition Regulation and the Department's contract with WSRC.

The inspection was conducted in accordance with Quality Standards for Inspections issued by the President's Council on Integrity and Efficiency.

III. SUMMARY RESULTS OF INSPECTION

In 1988, the Department of Energy conducted negotiations with both Martin Marietta Corporation and Westinghouse Electric Corporation (Westinghouse) to manage and operate the Savannah River Site. These negotiations included the determination of the total available fee that could be earned for the first six months of the award fee contract. Westinghouse Electric Corporation was ultimately selected as the successful bidder. Westinghouse Savannah River Company was designated as the management and operating (M&O) contractor, and was paid a fee of \$5.188 million for the first six month fee period. Since those initial and very competitive negotiations, WSRC's subsequent fee arrangements have increased to the point where they received a fee of \$17.262 million for the six month period ending in March 1994. This inspection reviewed the changes in the fee arrangements during this period. A brief summary of the key findings of this inspection follows:

- o Our review disclosed that, after FY 1989, SR increasingly subdivided WSRC's fee base (the total dollar value of the contract) into more numerous, smaller dollar value fee bases. WSRC increased from two fee bases in FY 1989 to eight in FY 1994. The result was that the sum of the fixed-fee-equivalents for the smaller fee bases exceeded the fixed-fee-equivalents based on the two initial, larger fee bases. This occurred because the schedules in the DEAR that are used as a basis for computing fixed-fee-equivalents are regressive. That is, as the size of the fee base increases, the incremental increase in fee percentage decreases. For example, Attachment A to this report indicates that the incremental fee percentage for "production" work between \$100 million and \$150 million should be limited to 1.1 percent; for work between \$200 million and \$300 million, the maximum fee for this incremental work declines to 0.5 percent.

- o We found that SR had significantly increased the percentage of the dollar value of WSRC's subcontracts that are added to WSRC's fee bases. In FY 1989, SR included 50 percent of the value of WSRC's subcontracts in the fee bases. By FY 1993, SR had significantly increased these percentages. For example, 100 percent of the value of a portion of work performed under one subcontract was included in WSRC's fee bases. Since the subcontractor was also receiving a fee for this portion of work, DOE was paying two full fees for the same work.
- o We found that SR had effectively increased WSRC's fixed-fee-equivalents by approximately \$3 million in both FY 1993 and 1994 to, in large part, fund WSRC's employee incentive compensation program. SR had declared this program to be an unallowable cost after FY 1992. We believe that funding WSRC's "unallowable" incentive compensation program through the mechanism of increased fee is inconsistent with current Departmental policy, and precludes effective DOE oversight of the program.
- o We found that WSRC's total paid fees for the period we reviewed increased significantly over what they would have received if the terms resulting from the original competitive negotiations had been maintained. In 1988, when Westinghouse Electric Corporation was competing against Martin Marietta Corporation, Westinghouse proposed a fixed-fee-equivalent (the basis for determining the total available fee) for FY 1989 that was 6.6 percent higher than that specified in the DEAR maximum fee schedules, but accepted a fee 11 percent less than that calculated from the schedules. For FY 1990, after contract execution, WSRC proposed a fixed-fee-equivalent seven times as large as the annualized amount it had accepted for FY 1989; and negotiated a fixed-fee-equivalent which was twice as large as the amount prescribed by the DEAR maximum fee schedules under the conditions of the initial contract negotiations.

Using WSRC's actual performance scores, we estimated that, during the first five years of the contract, WSRC would have received approximately \$70.9 million in total fees under the terms initially negotiated, or some \$59.7 million less than the \$130,621,000 actually received. Our calculations were based on the amount of fees that WSRC would have been paid if the fees had

been based upon fixed-fee-equivalents which: (1) were limited in amount to the maximum fee schedules (WSRC actually accepted less than the maximum the first negotiated fee period), and (2) were calculated in the same manner as the first fee period, including the use of one fee base per fee schedule. Initially, WSRC only had two fee bases, one for the production schedule and one for the research and development schedule.

Management officials, while concurring with the report's recommendations, commented on the report's findings. Although they did not question the facts presented in the report, they did not feel that the report adequately recognized the changes underway in the Department's fee process, nor the changes in the operating conditions of the WSRC contract. For example, the Office of Procurement said that, while it may have appeared as if rules were not being followed, the Department was attempting to analyze fees in accordance with a new management approach. Under this initiative, the total dollar value of the contract was subdivided into an increased number of separate fee bases, thus moving more to a task order approach for identifying fee base areas. We believe, however, that if the Department was moving to a task order mode, and thus subdividing fee bases, the Department should have considered using less than the maximum fixed-fee-equivalent allowed by the DEAR to determine total available fee. In our view, when the maximum fee schedules were established, the Department did not envision that a contractor would have eight separate fee bases, as was the case with WSRC in FY 1994.

The Office of Procurement further stated that the report did not take into account the increased risk borne by the contractor. SR also commented that the fee for WSRC was in fact in line with the "market price" for M&O contractors and provided data relative to selected contractors to support this position. We found, however, that unlike WSRC, one of the contractors cited had the "Accountability Rule" provisions in its contract which made it liable for certain avoidable costs and accordingly incorporated different fee provisions. We also found that one of the reasons the other contractors cited had higher fees was that they placed more of their base fee at risk in order to have a larger award fee pool.

IV. BACKGROUND

In 1988, Westinghouse Electric Corporation competed against Martin Marietta Corporation for a contract to manage and operate the Department of Energy's Savannah River Site (SRS) near Aiken, South Carolina. DOE selected Westinghouse as the replacement contractor on September 8, 1988. A five and one-half year contract, Contract No. DE-AC09-89SR18035, was subsequently signed by DOE and the Westinghouse Savannah River Company, to commence on April 1, 1989.

Under Clause H.24, Recognition of Performing Entity, of WSRC's contract with DOE, Bechtel Savannah River, Inc. (BSRI) was specified as part of the "entity" which manages and operates SRS. BSRI is responsible for certain elements of WSRC's statement of work, to include design and construction. Although BSRI is legally a subcontractor to WSRC, BSRI personnel are integrated within the overall WSRC organization.

With the exception of a relatively small "fixed fee" associated with WSRC's management of the Naval Fuels Materials Facility (which was eliminated after FY 1991), DOE's contract with WSRC is a cost-plus-award-fee (CPAF) contract. WSRC's subcontract with BSRI is also a CPAF contract. DOE annually negotiates a "total available fee" with WSRC; WSRC likewise annually negotiates a total available fee with BSRI, subject to DOE approval.

DEAR Section 970.1509 discusses fees for management and operating contracts. Section 970.1509-1, "Fee policy," states that M&O contractors may be paid a fee. The amount of the fee payable for an M&O contract will be established in accordance with DEAR 970.1509, and "shall not exceed maximum amounts derived from the appropriate fee schedule established for this purpose."

The maximum fees for M&O contracts are to be determined from the fee schedules which most closely relate to the services being performed. DEAR 970.1509-5, "Limitations," contains fee schedules which indicate the maximum allowable fees to be paid to M&O contractors for "Production Efforts" and "Research and Development Efforts." DEAR 915.971 contains fee schedules which indicate the maximum allowable fees to be paid to M&O contractors for "Construction" and "Construction Management."

These schedules are not necessarily intended to be used to calculate an appropriate "fixed-fee-equivalent" for an M&O's contract effort. Guidance for initially determining fees, using a judgemental process, is provided in DEAR 970.1509-4, "Considerations and techniques for determining fees." Instead, the primary purpose of these fee schedules is to establish a "maximum" fee limit which should ordinarily not be exceeded. Furthermore, if a DOE contracting officer intends to authorize a fixed-fee-equivalent which exceeds these "maximum" fees, then prior approval must be obtained from DOE's Procurement Executive.

As a practical matter, the Savannah River Operations Office has always used the maximum fee schedules in DEAR 970.1509-5 to develop proposed fees for WSRC, and not the more judgemental process described in DEAR 970.1509-4. Attachment A to the report shows DEAR 970.1509-5 maximum fee schedules which were in effect when WSRC's contract was being negotiated by DOE in 1988. Attachment B shows these same fee schedules after they were revised in June 1991 to reflect the impact of inflation since 1983.

One of the significant structural characteristics of these fee schedules is the decline in fee percentage as the size of the work/fee base increases. For example, Attachment A indicates that the incremental fee percentage for "production" work exceeding \$100 million (and less than \$150 million) should be limited to 1.1 percent; for work exceeding \$200 million (and less than \$300 million), the maximum fee for this incremental work declines to 0.5 percent. The significance of these declining percentages is discussed in more detail later in the report.

DEAR 970.1509-6, "Fee base," provides guidance on determining an appropriate estimate of necessary allowable costs (fee base) to be used in calculating a maximum allowable fee from the fee schedules. This section discusses various adjustments which should be made to the fee base (i.e., cost of work being performed) to better reflect the actual management and technical effort required of the contractor. Most frequently, this section discusses what should be excluded from the fee base. Examples of possible exclusions include any part of a subcontract which did not reflect the contractor's effort, and government furnished materials.

DEAR 970.1509-6 also states that there may be circumstances where the fee schedules do not reflect adequate compensation to the contractor, such as when the contractor uses its own

facilities and capital. In these circumstances, fee proposals exceeding the fee schedules should be submitted to the DOE Procurement Executive, documenting why the contractor is entitled to additional fees.

With the exception of DEAR 970.1509-8, all sections of DEAR 970.1509 address establishing a fixed-fee-equivalent for M&O contracts. DEAR 970.1509-8, "Special considerations - award fee," provides guidance on converting this fixed-fee-equivalent to an "award fee" basis.

The starting point in establishing an award fee is to first determine an appropriate fixed-fee-equivalent for the contract, either judgementally or by using the maximum fee schedules. This fixed-fee-equivalent would be the fee paid if the contract were on a cost-plus-fixed-fee (CPFF) basis, rather than an award fee basis. Once this fixed-fee-equivalent is determined and agreed to, a portion of the fixed fee-equivalent (0 to 50 percent) remains fixed as a "base fee," and is payable to the contractor in equal, normally monthly, installments. The remainder of the fixed-fee-equivalent is converted to an "award fee pool." The DEAR sets a maximum for the award fee pool at double the remaining fixed-fee-equivalent, after the base fee has been deducted. (Award fees exceeding this maximum require approval by DOE's Procurement Executive.) The contractor then earns some portion of this available award fee pool, based upon its performance during the award fee rating period. The base fee and the award fee pool together make up the total available fee under the award fee contract. The percentages of both the base fee and the award fee pool to the fixed-fee-equivalent are commonly referred to as the "award fee split." For example, if the base fee were set at 40 percent of the fixed-fee-equivalent, and the award fee pool were set at 120 percent of the fixed-fee-equivalent, then the award fee split would be "40/120."

V. RESULTS OF INSPECTION

As shown in Appendix II to the report, fees totaling \$130,621,000 had been paid to WSRC through March 31, 1994. Appendix III summarizes the award fee negotiation data by fiscal year. Appendix IV analyzes the growth in total available fees for WSRC to manage and operate SRS, from the time the contract was initially negotiated in 1988 through the first FY 1994 fee period.

The principal focus of the analyses in Appendix IV was a comparison of the basic fixed-fee-equivalents negotiated with WSRC, before being converted to an award fee basis, and the maximum fees per the fee schedules in DEAR 970.1509-5, as well as a discussion of the resulting variances. These analyses were the primary basis for the findings discussed in this section of the report.

A. SUBDIVISION OF FEE BASES

Our review disclosed that, after FY 1989, SR increasingly subdivided WSRC's fee base (the total dollar value of the contract) into more numerous, smaller dollar value fee bases. The result was that the sum of the fixed-fee-equivalents for the smaller fee bases exceeded the fixed-fee-equivalents based on the two initial, larger fee bases.

The Department of Energy Acquisition Regulation provides fee schedules for determining the maximum allowable fee to be paid under management and operating contracts. DEAR 970.1509-5 contains the maximum fee schedules for "Production Efforts" and "Research & Development Efforts;" DEAR 915.971 contains maximum fee schedules for "Construction" and "Construction Management" contracts.

A fundamental characteristic of these maximum fee schedules is that each schedule is regressive. As the size of the effort increases, the fee percentage decreases. If a larger effort is broken down into smaller pieces, fees are separately calculated for each of these smaller pieces using the higher fee percentages. As a result, the total fees for the smaller pieces will exceed the single fee for the larger effort.

In reviewing SR's calculation of WSRC maximum fees from the DEAR fee schedules, it is apparent that SR had increasingly subdivided the WSRC budget into additional, smaller fee bases prior to calculating the fee(s). The number of fee bases used by SR to calculate the "maximum" fees for the WSRC contract are shown, by category, in the following table:

(Continued on next page)

<u>Fiscal Year</u>	<u>Separate Fee Bases</u>			
	<u>Production</u>	<u>Research & Development</u>	<u>Construction Management</u>	<u>Total</u>
1989	1	1	-	2
1990	3	1	-	4
1991	3	1	-	4
1992	3	1	-	4
1993	3	2	-	5
1994	3	2	3	8

A result of subdividing the WSRC budget into more numerous fee bases has been to increase the total fixed-fee-equivalent calculated from the maximum fee schedules. Using FY 1990 as an example, SR initially calculated a maximum fixed-fee-equivalent of \$6.66 million for WSRC's "Production" efforts, based upon one "Production" fee base. Less than two months later, using the same data, SR recalculated a maximum fixed-fee-equivalent of \$10.61 million for WSRC's "Production" efforts, based upon three "Production" fee bases. Subdividing the "Production" effort into three fee bases increased the "Production" fixed-fee-equivalent by \$3.95 million, or 59 percent. SR partially justified the FY 1990 change in subdividing fee bases by concluding "that major changes since September 1988 in organizational alignment, both by DOE and WSRC, and in operating requirements" dictated that a different approach be used.

FY 1993 provides another example of the impact of subdividing fee bases. Allocating WSRC's budget among one "Production" fee base and one "Research and Development" (R&D) fee base, as was used in the contract's initial FY 1989 fee calculation, we calculated a total fixed-fee-equivalent of \$14.7 million from the maximum fee schedules in the DEAR. SR subdivided this same budget among three "Production" and two "R&D" fee bases, and calculated a total fixed-fee-equivalent of \$26 million from these same fee schedules. WSRC, in their initial fee proposal, subdivided the budget data into 61 fee bases and calculated a total fixed-fee-equivalent of \$66 million from, again, the same fee schedules.

In addition to increasing the number of fee bases from 1989 through 1994, SR had frequently changed the programmatic composition of the fee bases during this period, as the following data indicates:

(Continued on next page)

Composition of Fee Bases

FY 1989 Fee Bases

Production Fee Base: (1) Site Operations (Included 60% of Savannah River Laboratory (SRL) Fee Base)
R&D Fee Base: (1) Savannah River Laboratory (40% of SRL Fee Base)

1990, 1991, & 1992 Fee Bases

Production Fee Bases: (1) Site Operations
(2) Reactor Restart (RR)
(3) New Production Reactor (NPR)
R&D Fee Base: (1) Savannah River Laboratory (100% of SRL Fee Base)

Note: For 1990 - 1992, (a) two additional "Production" fee bases were recognized (RR and NPR); and (b) all SRL fee base was designated as "R&D," versus 40% in 1989.

1993 Fee Bases

Production Fee Bases: (1) Site Operations
(2) Reactors
(3) Environmental Restoration/Waste Management (ER/WM)
R&D Fee Bases: (1) Savannah River Laboratory
(2) Defense Waste Processing Facility (DWPF)

Note: For 1993, (a) the New Production Reactor effort was eliminated as a "Production" fee base due to termination of the program; (b) the ER/WM program was recognized as a new "Production" fee base; and (c) the DWPF effort was switched from "Production" to "R&D" and recognized as a separate "R&D" fee base.

1994 Fee Bases

Production Fee Bases: (1) Site Operations
(2) Environmental Restoration/Waste Management
(3) Savannah River Technology Center (SRTC)
(29.2% of SRTC Fee Base)
R&D Fee Bases: (1) SRTC (70.8% of SRTC Fee Base)
(2) DWPF
Construction Management
Fee Bases: (1) Site Operations
(2) Savannah River Technology Center
(3) DWPF

Note: For 1994, (a) Reactors was eliminated as a separate fee base; (b) a portion of the Savannah River Technology Center fee base (formerly SRL) was identified as a separate "Production" fee base; and (c) a new category of fee bases was identified ("Construction Management") with three new and separate fee bases placed in this category.

We found evidence that SR had disclosed to DOE Headquarters Procurement the various fee bases used in calculating WSRC's fixed-fee-equivalents from the maximum fee schedules. However, we did not find evidence in SR's procurement files that SR had adequately disclosed to DOE Headquarters

the impact of increased fees which resulted from SR's changes in both the number and programmatic composition of fee bases. Furthermore, an SR official confirmed that SR had not disclosed this type of information to DOE Headquarters.

In summary, we found that SR's subdivision of WSRC's budget into smaller fee bases, as well as SR's programmatic reconfiguration of these fee bases, resulted in substantially larger fixed-fee-equivalents being calculated from the maximum fee schedules within the DEAR. We concluded that, while some flexibility for restructuring fee bases may be necessary, this process needs to be more closely controlled.

B. SUBCONTRACT FEE BASE VALUES

We found that SR had significantly increased the percentage of the dollar value of WSRC's subcontracts that are added to WSRC's fee bases. For example, 100 percent of the value of a portion of work performed under one subcontract was included in WSRC's FYs 1993 and 1994 fee bases. In our view, assigning too much weight to subcontracts in fee bases is not consistent with the partial exclusion of subcontracts' costs as discussed in the DEAR.

DEAR 970.1509-6, Fee base, defines a fee base as "an estimate of necessary allowable costs to which a fee factor has been applied to determine the maximum fee allowance." This section further states that the fee base shall exclude any part of costs which are of such magnitude or nature as to distort the technical and management effort actually required of the contractor. The "estimated cost or price of subcontracts and other major contractor procurements" is listed as one type of cost which may, in some part, be excluded from the fee base.

When the WSRC contract was in the process of being negotiated in 1988, SR reduced the value of subcontracts in the fee base by 50 percent. SR's Business Management Committee, in commenting on Westinghouse's initial fee proposal, stated:

"However, in developing the fee proposal Westinghouse has overlooked a factor which will tend to lower the fee even more. All of the construction and A-E effort will be performed by a subcontractor, Bechtel. Subcontract costs don't carry the same weight as in-house costs

(subcontract costs are usually reduced by 50% or more) in fee calculation."

We did note, however, a trend by SR to include an increasing percentage of the subcontracts' value in the fee base when calculating fixed-fee-equivalents from the DEAR's maximum fee schedules. SR, as partial justification for its FY 1991 prenegotiation fee objective, stated varying percentages were used for subcontracts in WSRC's fee bases to more accurately reflect WSRC's actual management effort. The following table summarizes WSRC's subcontract fee base values from FY 1989 through FY 1994:

Fiscal Year	Subcontracts/Fee Base	Percentage of Subcontract Costs Included In Fee Base
1989: All		50
1990: <u>Initial Calculations</u>		
Site Operations		50
Savannah River Laboratory		50
Bechtel Direct Design & Construction		65
Bechtel Subcontracts		50
1990: <u>Revised Calculations</u>		
Site Operations		50
New Production Reactor		50
Reactor Restart		75
Savannah River Laboratory		50
Bechtel Direct Design & Construction		65
Bechtel Subcontracts		50
1991: Site Operations		50
New Production Reactor		50
Reactor Restart		75
Savannah River Laboratory		50
Bechtel, all work/subcontracts		65
1992: Site Operations		50
New Production Reactor		50
Reactor Restart		75
Savannah River Laboratory		50
Bechtel, all work/subcontracts		65
1993: Site Operations		50
Reactor Restart		70
Environmental Restoration/Waste Management		60
Defense Waste Processing Facility		70
Savannah River Laboratory		70
Bechtel, excluding below		65
Bechtel employees within WSRC organization		100
1994: Site Operations		50
Environmental Restoration/Waste Management		60
Defense Waste Processing Facility		70
SRTC (Formerly Savannah River Lab)		70
Bechtel, excluding below		80
Bechtel employees within WSRC organization		100

The above data clearly indicates an increasing trend in SR's "weighting," or valuation of subcontracts for fee base purposes. For the FY 1989 total available fee calculation, all subcontracts were weighted at 50 percent. In FY 1990, weighting of Bechtel's direct design work and construction increased to 65 percent. Also, Reactor Restart subcontracts were increased to 75 percent in FY 1990. In FY 1991, subcontracts associated with Bechtel's work were increased to 65 percent. For FY 1993, (1) the Savannah River Laboratory subcontracts were increased to 70 percent; (2) subcontracts in the Environmental Restoration/Waste Management and Defense Waste Processing Facility fee bases, which were previously included in Site Operations at 50 percent, were also increased to 60 percent and 70 percent respectively; and (3) the budget for Bechtel employees within the WSRC organization received a full 100 percent valuation in the WSRC fee base. In FY 1994, Bechtel's construction work was increased from 65 to 80 percent.

The 100 percent weighting of Bechtel's work in WSRC's FYs 1993 and 1994 fee bases resulted in: (1) Bechtel receiving a fee for its work from WSRC; and (2) WSRC receiving full fee credit from DOE for the same work. Since DOE reimburses WSRC for allowable costs under the M&O contract, including the fees paid to Bechtel, the Government, in effect, paid two full fees for the same work. The 80 percent weighting of Bechtel's construction work in FY 1994 approaches the same situation: WSRC (and DOE) paid Bechtel full fee for its work, and WSRC received 80 percent credit for the same work in its fee calculation.

Based upon the above data, we concluded that SR had included too high a percentage of the dollar value of WSRC's subcontracts in its fee bases, resulting in increases in the fixed-fee-equivalents being calculated from the DEAR maximum fee schedules. In view of the Department's recent initiative to subcontract out work previously performed by the Department's M&O contractors, a proper weighting of these subcontracts in M&O fee calculations becomes even more significant.

C. FUNDING INCENTIVE COMPENSATION THROUGH FEES

We found that SR had effectively increased WSRC's fixed-fee-equivalents by approximately \$3 million in both FY 1993 and 1994 to, in large part, fund WSRC's employee incentive compensation program. SR had declared this program to be an unallowable cost after FY 1992.

During the first three calendar years of the WSRC contract, SR authorized, as an allowable cost, an incentive compensation program for WSRC employees. The details of this incentive compensation program were discussed at length in an Office of Inspector General report on "Inspection of the Department of Energy's Procedures for Administering Contractors' Executive Employees' Compensation," Report DOE/IG-0332, dated August 1993.

In a July 1992 letter to WSRC's Executive Vice President, SR's Manager stated that he had concluded it was no longer in the best interests of the Government to recognize employee incentive compensation as an allowable cost under the contract between DOE and WSRC. At the time of this letter, the 1992 incentive compensation performance period, which was on a calendar year basis, was a little over one-half completed. In February of 1993, WSRC awarded and paid incentive compensation to covered employees for the Calendar Year (CY) 1992 performance period. These costs were not directly reimbursed by DOE as allowable costs under the contract.

A review of the total available fee negotiation files for FY 1994 revealed that SR did, in fact, assist WSRC in funding its "unallowable" incentive compensation program by increasing WSRC's fees. Specifically, an SR briefing chart, which was included in a presentation to SR's Manager in December 1993, indicated that \$3 million in WSRC's FY 1993 base fee represented an "allowance" for employee incentive compensation.

Another SR briefing document, dated December 10, 1993, summarized the results of a meeting at DOE Headquarters. This meeting, attended by senior Headquarters program and procurement officials and SR personnel, dealt with WSRC's FY 1994 fee options. Under the heading "OUTCOMES OF THE MEETING," the document stated: "IT WAS REAFFIRMED THAT THE FY93 \$3M [million] BUYOUT OF INCENTIVE COMPENSATION WILL CONTINUE IN FY94 AND FUTURE YEARS."

We believe that funding an "unallowable" incentive compensation program through the mechanism of increased fee effectively eliminated meaningful involvement and oversight of the program by the Department. The Department has no authority to obtain answers to such basic and fundamental questions as the following:

- o Does WSRC have an incentive compensation program?
- o What is the program's annual expenditures?
- o Which WSRC employees participate in the program?
- o Are employees in the program adequately compensated without incentive compensation?
- o Does criteria for earning incentive compensation meet DOE objectives?
- o Did the employees' performance merit incentive compensation?

At least one SR employee did not share our concern regarding the lack of involvement and oversight by DOE in funding WSRC's incentive compensation program through the mechanism of increased fee. During our inspection, we reviewed an unsigned internal document, dated October 1992 and addressed to SR's Manager, that discussed various funding options for WSRC's incentive compensation program. It stated, in part:

"- there are two ways WSRC can recover IC [incentive compensation] costs: through fee or as an allowable cost. I would prefer the fee approach as this would exclude any DOE involvement in the process."

* * * * *

"- The above would, in my mind, provide more than enough in additional fixed fee to cover the cost of the IC program [\$2.7MM last year] and an additional amount to reflect something for Task order contracting. The formal record would not show that we have done either!"

We also noted that the Department's assistance in funding WSRC's "unallowable" incentive compensation program through increased fee appears to be inconsistent with current Departmental policy. In comments to our Report DOE/IG-0332, the then Deputy Director, Office of Procurement, Assistance and Program Management, stated as current policy that "incentive compensation programs, which increase the cost of employee compensation, will not be an allowable cost in the future, and existing incentive programs will be evaluated for continuation or termination as current contracts expire."

If the policy is to stop paying for these incentive compensation programs as "allowable" costs, as SR has done, we believe it is inconsistent to continue "paying" for them by increasing fees. We further believe that the Department's assistance to WSRC in funding its "unallowable" incentive compensation program through the mechanism of increased fee precludes effective DOE oversight of the program and should be terminated.

D. BENCHMARKING FEES

We concluded that it would have been advantageous to the Department to have used WSRC's initially negotiated fee parameters to benchmark fees paid to WSRC in subsequent fee periods. We noted a lack of consistency between fees initially bid and (a) the contractor's fee expectations and requests in subsequent fee periods, and (b) total available fees actually negotiated by the Department in subsequent periods.

In 1988, when Westinghouse was competing against Martin Marietta Corporation for the contract, Westinghouse submitted a fee proposal based on a fixed-fee-equivalent of \$6 million for the initial six month fee period of FY 1989. This amount was 6.6 percent higher than the maximum fee schedules in the DEAR. After negotiations, Westinghouse accepted a fixed-fee-equivalent of \$5 million, which was 11 percent less than the DEAR's maximum fee schedules.

After Westinghouse was selected for contract award, the subsequent annual total available fee negotiations between SR and WSRC appeared to become a wide open process without regard to the fee terms originally negotiated. The annual negotiation process typically involved WSRC submitting a very large initial fee proposal, and SR agreeing, after protracted negotiations lasting well into the applicable fee year, to a fixed-fee-equivalent much higher than that specified in the DEAR's maximum fee schedules.

For example, less than six months after the start of the new contract, WSRC submitted a FY 1990 proposal for a \$70 million fixed-fee-equivalent. This was seven times the annualized fixed-fee-equivalent amount negotiated the previous year, when competition was still ongoing. WSRC's negotiation technique appears to have been effective since SR finally agreed to a \$20 million fixed-fee-equivalent, which was approximately double that specified in the DEAR's

maximum fee schedules. The negotiations finally concluded with Modification M020 being signed on June 4, 1990, some eight months into the FY 1990 fee year.

The negotiation process in subsequent years substantially followed this pattern, as the following data indicates:

Fee/ Fiscal Year	WSRC		SR		Contract Mod. Dated
	Fixed-Fee- Equivalent Per DEAR*	Proposed Fixed-Fee Equivalent	Negotiated Fixed-Fee Equivalent	Percent **	
1990	\$10.1MM	\$70.0MM	\$20.00MM	198	06-04-90
1991	11.7MM	24.4MM	21.75MM	186	06-04-91
1992	14.2MM	61.6MM	26.50MM	187	06-05-92
1993	14.7MM	66.0MM	29.75MM	202	03-19-93
1994	16.4MM	39.0MM	29.00MM	177	04-08-94

* DEAR Fixed-Fee-Equivalent amount based upon one fee base per schedule (e.g., one "Production" fee base, one "R&D" fee base, etc.)

** SR Negotiated Fixed-Fee-Equivalent divided by Fixed-Fee-Equivalent Per DEAR.

A general trend of DOE paying increasingly higher fees to WSRC is discernible from data presented in Appendix II of our report. Even after the major increase in fees from FY 1989 to FY 1990, fees paid have continued to increase in subsequent years. In some instances, these increases have occurred in the face of declining budgets and lower performance scores.

As a basis of comparison, we used FY 1991 when the WSRC contract budget was \$2.054 billion. For the second six month evaluation period of FY 1991, WSRC received a numerical performance score of 88, and a total fee of \$13,045,000.

For FY 1992, the WSRC contract budget was \$2.017 billion, or \$37 million less than for FY 1991. For the second six month evaluation period of FY 1992, WSRC received a numerical performance score of 89, and a total paid fee of \$16,287,500. Comparing this score and fee with the second period of FY 1991, the score increased by one point while the paid fee increased by \$3,242,500. We do not believe a \$3,242,500, or approximately 25 percent, increase in paid

fee for a six month evaluation period can be explained by a one point increase in score, especially in view of a decline in budgeted activity.

More recently, the FY 1994 WSRC contract budget was \$1.822 billion, or \$232 million less than the FY 1991 level. For the first six month evaluation period of FY 1994, WSRC received a numerical performance score of 85, and a total paid fee of \$17,262,250. Comparing this score and fee with the second period of FY 1991, the score decreased by 3 points while the paid fee increased by \$4,217,250. Again, we do not believe a 32 percent increase in fee for a six month evaluation period is warranted with declines in both budgeted activity and the performance score.

During June 1991, DOE changed its fee policy for certain profit making M&O contractors in two ways. First, the Department significantly increased the fees that these M&O contractors could earn under their contracts. In the highest fee category, contractors would receive 100 percent of the fixed-fee-equivalent as their base fee, plus an additional 200 percent of the fixed-fee-equivalent as their award fee pool, giving them a total available fee of 300 percent of the fixed-fee-equivalent. Second, in exchange for these higher fees, the Department made these M&O contractors financially responsible for certain avoidable costs. The contractor would now be responsible for avoidable costs in the areas of property, fines and penalties, litigation and claims, and other losses which were incurred due to negligence or willful misconduct on the part of the contractor. These changes are collectively referred to as the "Accountability Rule."

WSRC does not have the "Accountability Rule" provisions in its contract and, therefore, is not currently financially responsible for avoidable costs. However, WSRC's original fees have increased to the point where they are almost equal to the 100 percent base fee and 200 percent award fee pool available to those M&O contractors under the "Accountability Rule." Using WSRC's total available fees for FY 1991 as an example, WSRC negotiated a base fee of \$10.9 million and an award fee pool of \$21.7 million. If a fixed-fee-equivalent were calculated for FY 1991 on the same basis as the initially negotiated fee (i.e., one fee base per schedule), the fixed-fee-equivalent would be \$11.65 million. The negotiated base fee of \$10.9 million was 94 percent of this \$11.65 million fixed-fee-equivalent, and the \$21.7 million award fee pool was 186 percent of this fixed-fee-equivalent. Thus, the total available fee, \$32.6 million, was

approximately 280 percent of the \$11.65 million fixed-fee-equivalent discussed above.

During the first five years of its contract with the Department, WSRC was paid total fees of \$130,621,000. We have estimated the amount of fees that WSRC would have been paid if fees had been based upon fixed-fee-equivalents which: (1) were limited in amount to the maximum fee schedules (WSRC actually accepted less during negotiations for the first fee period); and (2) were calculated in the same manner as the first fee period, by using only one fee base per fee schedule. Using WSRC's actual award fee splits and performance scores, we have estimated that WSRC would have received approximately \$70.9 million in total award fees under the terms initially negotiated, or some \$59.7 million less than actually received.

In our opinion, the fees initially bid by contractors should be used as the basis for negotiating additional total available fees over the life of the contract. For example, if the initially negotiated fixed-fee-equivalents were the DEAR maximum plus 10 percent, then the subsequent fees paid during the contract should be kept very close to this benchmark. The contractor should be made aware that the initial fee, and its relationship to the DEAR, will essentially benchmark the fee for the life of the contract, unless some very unusual and unforeseen circumstances arise.

The mechanism for implementing this policy is already in place. DEAR 970.5204-54, "Basic fee and award fee," is a relatively new standard clause; it was incorporated in the DEAR, and the WSRC contract, in June of 1991. In Section 970.5204-54(b), Fee Negotiations, the clause states:

"If the parties are unable to agree on a reasonable fee, the contracting officer shall unilaterally determine the basic fee and the available award fee, subject to the clause of this contract entitled Disputes."

We believe that effective use of this clause can help maintain a basic relationship and continuity between fixed-fee-equivalents initially negotiated, particularly during competition, and those negotiated in subsequent fee periods.

In summary, we noted a lack of consistency between fees bid and accepted by the contractor during the initial competitive fee negotiations, and (a) the contractor's fee

expectations and proposals in subsequent fee periods; and (b) the fixed-fee-equivalents actually negotiated by the Department in subsequent fee periods. We further noted that current contract reform efforts within the Department have endorsed the benefits of recompeting expiring M&O contracts rather than renewing them. If one of the benefits of recompeting these contracts, specifically a competitively negotiated fee, is to be "lost" soon after the initial contract is awarded, then the impact of contract reform will be unnecessarily limited.

We concluded that it would have been advantageous to the Department to have used WSRC's initially negotiated fees to benchmark fees paid to WSRC in subsequent fee periods. We believe a benchmarking of a contract's initial fees with the DEAR maximum fee schedules should be maintained in subsequent fee periods unless significant changes in circumstances warrant otherwise.

E. DOCUMENTATION OF TOTAL AVAILABLE FEE NEGOTIATIONS

In conducting our review, we noted two instances in which SR had not properly documented total available fee negotiations with WSRC in conformance with DEAR requirements. DEAR 915.808 requires that a price negotiation memorandum be prepared after the conclusion of contract actions exceeding \$250,000. The post negotiation section of this memorandum is to "discuss the results of the negotiations leading to a final agreement, and, in a general sense, provide the results of the negotiations in terms of the extent to which prenegotiation objectives were met."

For FY 1990, SR ultimately negotiated a total available fee with WSRC based upon a fixed-fee-equivalent of \$20 million, approximately twice the DEAR maximum. These FY 1990 negotiations, which resulted in total available fees of \$31.5 million, essentially established the fee pattern for the next three years. Irrespective of the significance of this negotiation, SR has never prepared a price negotiation memorandum documenting the FY 1990 total available fee negotiations.

In the second instance, SR negotiated with WSRC a total available fee of \$43.5 million for FY 1993. The modification of the contract to reflect this total available fee was signed on March 19, 1993. At the completion of our field work, SR had yet to prepare a price negotiation memorandum for these FY 1993 total available fee negotiations.

VI. RECOMMENDATIONS

We recommend that the Deputy Assistant Secretary for Procurement and Assistance Management:

1. Require that change(s) in either the number or composition of fee bases used in calculating fees from the maximum fee schedules in the DEAR, along with the impact on total fees resulting from such changes, be submitted to the DOE Headquarters Procurement Executive for approval.
2. Establish a standard for weighting subcontracts in fee bases, and a requirement for justification and approval when the standard is exceeded.
3. Ensure that negotiated total available fees do not include additional fee, either directly or indirectly, for the purpose of assisting contractors in funding "unallowable" incentive compensation programs.
4. Ensure that, as M&O contracts are competed/recompeted, initially negotiated total available fees, and the relationship of the fixed-fee-equivalents to the maximum fee schedules within the Department of Energy Acquisition Regulation, are used to benchmark fees negotiated in subsequent periods, and that significant changes in circumstances impacting the benchmarks are documented.

The Associate Deputy Assistant Secretary for Procurement and Assistance Management concurred with Recommendations 1 through 4 above. He stated that, regarding Recommendations 1, 2, and 3, the guidance contained in the DEAR is in the process of being revised, and "Such revisions are anticipated to be submitted into the Rule Making Process during October 1995." Additional comments were provided as follows:

Recommendation 2. "We agree more specific guidance can be promulgated in this area. To the extent subcontract costs are included in the fee base, such costs should properly reflect the extent of the prime contractor's involvement and risk. However, it is recognized that the determination of involvement and risk is subjective and is, therefore, not easily subject to arbitrary standards. However, we will review this area of concern and to the degree possible,

specific guidance will be developed. In situations where subcontract costs in excess of the guidelines are included in the fee base and justified, the action will be appropriately documented."

Recommendation 3. "We agree that negotiated fees will not include additional fee for the purpose of assisting contractor's (sic) in funding "unallowable" incentive compensation programs. However, this is not to say that the contractor may not use any fees earned as it deems appropriate. It is the policy of the Procurement Executive and the DOE Headquarters that fees be calculated on fair and reasonable costs under the contract. Such costs do not include specific amounts for incentive compensation programs. Compliance with this stated policy will be ensured through the clearance review process."

Recommendation 4. "While we agree in principal with the proposed concept, it must be recognized that negotiated fees should reflect the current work the contractor is required to perform. In the past, as the work scope has changed, the Department has been slow to adjust the fee to reflect the change (increase or decrease). Currently and in the future, as the DOE program changes to reflect Departmental realignment, the work scope provided to DOE management and operating contractors will change. The DOE must have the latitude but be more timely in adjusting fee (increase or decrease) to reflect these changes. However, the original negotiated fees will serve as a benchmark for subsequent negotiations regarding added work."

We recommend that the Manager, Savannah River Operations Office:

5. Ensure that future price negotiation memorandums are prepared in accordance with the requirements of DEAR 915.808.

The Manager, Savannah River Operations Office, concurred with Recommendation 5. Subsequent to providing comments, SR management, by a memorandum dated July 10, 1995, reminded SR contract specialists that all contract actions were to be documented as required by DEAR 915.808. The contract specialists were also reminded that post-negotiation summaries, when required, are to be completed as soon as practicable after the conclusion of negotiations.

VII. MANAGEMENT COMMENTS

Both the Office of Procurement and Assistance Management and the Savannah River Operations Office reviewed a draft of this report and provided comments. Some of their comments were incorporated as changes to the report, and others, along with our remarks, are presented below.

Office of Procurement and Assistance Management

The Associate Deputy Assistant Secretary for Procurement and Assistance Management, in commenting on the draft report, stated that "In general, the subject Inspector General (IG) Report was found to be accurate and factually correct." He continued on, however, to describe how the Department's approach in determining fees has been changing. His specific comments include the following:

" . . . [A Departmental] initiative resulted in the intentional identification of distinct performance areas or key elements of work under each contract. The new 'task order' approach changed past practice. . . .

"Each work area or 'program', as recognized, made independent demands on the contractor's resources and management skills. . . . Having begun to recognize that M&O contracts were not for a single specific effort anymore . . . it followed that in order to adequately motivate and reward the contractors for each 'program' area, the related fees would have to also recognize this new program or task breakout, as well as the breakout by category (R&D/Production/Construction). . . .

"The new approach is somewhat akin, in contracting terms, to a Basic Ordering Agreement, where the general scope of work, and structure are identified at time of award, but the specific work, cost and fees are established in increments, from time-to-time. . . . Further, the estimated cost and fee for specific work efforts, while considering the general parameters of the initial award to the extent they remain valid, reflects the complexity and risk of the specific annual work requirement being established.

"Under this new approach, the specific fee schedules are still applicable . . . but instead of being applied at the total annual cost value for one or two work categories, they are applied to a number of distinct performance or program areas which are agreed upon. While this allows for the possibility of higher fees, fees thus determined are considered more reflective of the specific demands placed on the contractor's resources and the risk of performance

"Contrary to the conclusions of the IG, what has been occurring over the past several years is not fee 'inflation', but an adjustment to fee resulting from the recognition that the previous application of fee was not reflective of the increased demands made of or risk borne by the contractor to meet the Department's demands and expectations in respective program areas.

". . . The period of review by the IG under the subject audit [inspection] report is for a period where in the Department was attempting to analyze fees in accordance with the new management approaches. Accordingly, it is to be expected the files and documentation would be reflective of a different approach from those used in the past and as addressed in the regulation, thus giving the appearance rules were not being followed. As a result of these and subsequent changes being brought about by the Department's Contract Reform initiatives, the regulations and guidelines will be changed to reflect the new concepts."

The Office of Inspector General believes that, if the Department was moving to a task order mode, and thus subdividing fee bases, as management commented, the Department should have considered using less than the maximum fixed-fee-equivalent allowed by the DEAR to determine total available fee. In our view, when the maximum fee schedules were established, the Department did not envision that a contractor would have eight separate fee bases, as was the case with WSRC in FY 1994.

Regarding management's comment that ". . . the previous application of fee was not reflective of the increased demands made of or risk borne by the contractor to meet the Department's demands and expectations in respective program

areas.", we have noted that these changes in circumstances have not, in our opinion, been adequately addressed in the fee justification documentation. Furthermore, we continue to question the increases in WSRC fees which have occurred, in some instances, in the face of declining budgets and performance scores.

Savannah River Operations Office

As a general comment on our draft report, SR pointed out that approval had been obtained from both the Procurement Executive, as required, and from programmatic officials for WSRC fees exceeding maximum fee schedules within the DEAR. Other SR comments, along with our remarks, are presented below.

- o SR commented that including 100 percent of the cost of a subcontract within a fee base is not inconsistent with the Federal Acquisition Regulation Weighted Guidelines method of fee calculation. In addition, the DEAR indicates that the amount of a subcontract to be included in a fee base is a judgemental issue. Therefore, the report's conclusion that too much of a certain subcontract's value has been placed in a fee base is an opinion without a basis of support.

Although our conclusion does represent an element of judgement, we believe it can be supported on the basis of DEAR 970.1509-6(b), which states, in part:

"The fee base, in addition to the above adjustments, shall exclude: (1) Any part of the following types of costs which are of such magnitude or nature as to distort the technical and management effort actually required of the contractor:"

* * * * *

"(ii) Estimated cost or price of subcontracts and other major contractor procurements"

This section of the DEAR indicates to us that a valuation of Bechtel subcontract efforts at less than 100 percent, and quite possibly less than the 80 percent used for Bechtel Construction efforts, would be appropriate. In addition, we have noted that certain Bechtel efforts

now being placed in the fee base at a full 100 percent valuation were only valued at 50 percent at the start of the contract in FY 1989.

- o SR commented that "By negotiating the incentive compensation out of the contract as an allowable cost, SR removed itself from interfering with the contractor's managerial responsibilities to determine which of its employees were entitled to receive incentive compensation payments. The removal of incentive compensation as an allowable cost under the contract simply meant the costs could not be directly billed to the contract. SR's approach in 1994 was to recognize the incentive compensation program existed but to let WSRC pay it out of WSRC's fee earnings. This is in total consonance with Contract Reform in that it epitomizes 'pay for performance' as well as removes the Government from micro management of the contractor."

We would point out that when the Government funds a specific contractor program, in this case incentive compensation, either directly as an allowable cost, or indirectly by increasing fee above what it would normally be, the effect is the same in both cases - it represents a "cost" to the Government. While we are not advocating micro-managing contractors, we believe there should be some assurance that funds provided to a contractor for a specific purpose are spent for that purpose. Funding an incentive compensation program through the mechanism of increased fee provides no such assurance.

- o SR commented that the \$3 million in the FY 1993 fee, which the report attributes "specifically" for funding WSRC's "unallowable" incentive compensation program, was incorrect; the agreement on fee was actually one of ten agreements being collectively settled during the negotiations. However, SR further stated that "In FY 1994, incentive compensation continued to be treated as an unallowable cost. Any payment of incentive compensation for WSRC will have to come out of its fee."

We have modified the text to indicate that the \$3 million fee increase was "in large part" to fund this program. While recognizing that other issues may have had some impact on reaching the \$3 million figure, various written comments in SR's procurement files would indicate that the

\$3 million was principally linked to the incentive compensation buyout.

- o SR commented that ". . . no factual basis exists to support the [report's] hypothesis that SR effectively increased the [FY 1994] fixed-fee equivalent to \$29 million in order to fund the incentive compensation program. The fee was established by developing the \$26 million cost-plus-fixed-fee (CPFF) equivalent and then allocating the \$26 million across the 10 program areas. Once the CPFF equivalent was established for each area, the base and award fee dollars were negotiated with WSR, which in part was based upon the willingness of WSR to accept risk within each area. There was no distortion of calculations to provide for inclusion of \$3 million for incentive compensation payments."

Our conclusion that WSR's FY 1994 fee arrangements included \$3 million to fund WSR's incentive compensation program, was based in large part, on a briefing document in SR's procurement files. This document, dated December 10, 1993, summarized the results of a meeting at DOE Headquarters concerning WSR's FY 1994 fees. Both SR and Headquarters officials attended the meeting. Under the heading "OUTCOMES OF THE MEETING," the document stated: "IT WAS REAFFIRMED THAT THE FY93 \$3M [MILLION] BUYOUT OF INCENTIVE COMPENSATION WILL CONTINUE IN FY94 AND FUTURE YEARS."

- o SR commented that providing additional fee to WSR for the reactor restart program and the NPR program was warranted, and further stated: "Although both programs were recognized as covered under the broad scope of the contract, fees for management and operating contractors are based upon budgetary dollars and difficulty of work. No one within DOE contemplated the reactor restart program would grow to the proportions it did. This is evidenced by the constant reschedule revisions resulting in the program changing from a six-month restart schedule to one which lasted over 4 years and required extensive resources. The NPR decision had not been made when the contract was competed and the scope of work merely recognized such a program might occur and would be within the general scope of the contract. . . . Once the decision was made to pursue the NPR, funding and the complexity of the program justified the additional fees in our, and HQ's, opinion."

- o SR commented that the FY 1992 fee calculation labeled "standard" in Appendix IV of our report was actually one of various fee calculation methods being compared. SR further commented that, in addition to calculating fees using these methods, they had made a "market price" comparison between WSRC's 1991 fees and fees paid to other M&O contractors, as shown below:

<u>Location</u>	<u>Budget (MM)</u>	<u>Total Fee (MM)</u>	<u>Percentage</u>
Rocky Flats-EG&G	\$890 (9 months)	\$26	2.9
Hanford-Westinghouse	\$1,032	\$18.2	1.76
Oak Ridge- Martin Marietta	\$1,500	\$26.3	1.75
SR-WSRC	\$2,054	\$32.6	1.59

SR further commented: "Based upon this comparison, it appeared the fee for WSRC in 1991 was in fact in line with the 'market price' for M&O contractors. The 1991 fee for WSRC was totally in line with the other M&O contractors' fee even though the WSRC fee included the 42 percent multiplier over the calculated fee."

We analyzed the above data, which was in fact transmitted to Headquarters by SR in justification of WSRC's 1992 fee, and came to different conclusions, as explained below:

- a. The magnitude of EG&G's fee was due to EG&G having the "Accountability Rule" provisions, including the associated increased financial risks, in its contract. The "Accountability Rule" reduces the indemnification of the contractor and makes it liable for certain "avoidable" costs. Accordingly, the method of calculation for total available fee is different. WSRC does not have these provisions in its contract and is not subject to these risks. Using the "Accountability Rule" provisions, EG&G's fee structure was based on a 100 percent "basic" fee (or fixed-fee-equivalent) of \$8.667 million and a 200 percent award fee pool of \$17.333 million. If EG&G's "basic" fee was converted to WSRC's 1991 fee structure, using WSRC's contract provisions, the result would be a 50 percent base fee of \$4.333 million and a 100 percent award fee pool of \$8.667, for a total available fee of \$13 million.

Furthermore, \$13 million would represent 1.46 percent of EG&G's budget of \$890 million. This was less than WSRC's 1.59 percent of its budget, even though WSRC's budget was 230 percent larger than EG&G's. As previously stated, maximum fee schedules are regressive and provide for declining fee percentages as budgets increase.

- b. Westinghouse/Hanford's total fee is erroneously stated as \$18.2 million; the actual amount, according to procurement officials in DOE's Richland Operations Office, was \$16.2 million, or 1.57 percent of its budget. In contrast, WSRC's total fee was 1.59 percent of its budget, even though its budget was approximately double that of Westinghouse/Hanford. Again, given that the maximum fee schedules in the DEAR are regressive, and prescribe smaller fee percentages for larger efforts, it would be expected that WSRC's fee percentage would be lower than Westinghouse/Hanford's, not higher as was the case. Furthermore, Westinghouse/Hanford had \$12.88 million, or approximately 80 percent of its fee at risk in the award fee pool, whereas WSRC had only 67 percent of its fee at risk.
- c. Martin Marietta's total fee of \$26.3 million included 84 percent, or over \$22 million, at risk in the award fee pool, versus 67 percent at risk for WSRC.
- o SR commented that the importance of the revised WSRC fee curve in FY 1994 was overlooked in Appendix IV of this report. A mid-satisfactory rating (numerical performance score of "80") under the revised curve would result in the contractor earning only 45 percent of its available award fee, versus 50 percent under the previous curve.

We agree that the contractor would earn less under the revised award fee curve with a numerical performance score of "80." We noted, however, that WSRC's historical performance scores through the first ten performance periods averaged "84.2," which is higher than a mid-satisfactory rating. An earned numerical performance score of "84" in FY 1994, applied to the revised fee curve, would have resulted in an increase in paid fee of \$400,000.

APPENDIX I

DEFINITIONS OF TERMS USED

Fixed-Fee-Equivalent: The fee that would be paid if a contract were a "cost-plus-fixed-fee" contract instead of an "award fee" contract.

Total Available Fee: The total available fee for an "award fee" contract, made up of two components, Base Fee and Award Fee Pool.

Base Fee: A percentage of the Fixed-Fee-Equivalent, anywhere from zero percent to 50 percent, that remains "fixed," and is paid in equal monthly installments.

Award Fee Pool: The remainder of the Fixed-Fee-Equivalent after the Base Fee is deducted, that is then [normally] doubled in amount, and "earned" by the contractor based upon the contractor's performance.

Award Fee Split: The percentage of the Fixed-Fee-Equivalent placed in the Base Fee, and the remaining percentage, doubled, placed in the Award Fee Pool. Generally expressed as two numbers, such as 40/120 (signifying 40 percent of the Fixed-Fee-Equivalent is in the Base Fee, with the remaining 60 percent being doubled to 120 percent in the Award Fee Pool.)

Fee Base: An estimate of necessary allowable costs, to include some percentage of subcontract costs, used in calculating the Fixed-Fee-Equivalent from the Maximum Fee Schedules.

Maximum Fee Schedules: Tables within the Department of Energy Acquisition Regulation which specify maximum fees (Fixed-Fee-Equivalent) which should be paid under M&O contracts based upon type of effort (e.g., Production, Research & Development, Construction Management) and size of effort (Fee Base).

APPENDIX II

FEE EVALUATIONS AND DOLLARS
 Westinghouse Savannah River Company
 April 1, 1989 - March 31, 1994

<u>Evaluation Period</u>	<u>Numerical Performance Score</u>	<u>Adjective Rating *</u>	<u>Base Fee</u>	<u>Available Award Fee Dollars</u>	<u>Award Fee Dollars Earned</u>	<u>Total Fee Dollars Earned</u>
(FY 1989) 04/1/89-9/30/89	81	Good	\$1,250,000**	\$7,500,000	\$3,937,500	\$5,187,500
(FY 1990) 10/1/89-3/31/90 04/1/90-9/30/90	90 85	Excellent Good	\$5,000,000** \$5,000,000**	\$10,000,000 \$10,000,000	\$7,500,000 \$6,250,000	\$12,500,000 \$11,250,000
(FY 1991) 10/1/90-3/31/91 04/1/91-9/30/91	80 88	Satisfactory Good	\$5,450,000** \$5,450,000**	\$10,850,000 \$10,850,000	\$5,425,000 \$7,595,000	\$10,875,000 \$13,045,000
(FY 1992) 10/1/91-3/31/92 04/1/92-9/30/92	84 89	Satisfactory Good	\$6,500,000 \$6,500,000	\$13,500,000 \$13,500,000	\$8,032,500 \$9,787,500	\$14,532,500 \$16,287,500
(FY 1993) 10/1/92-3/31/93 04/1/93-9/30/93	82 78	Satisfactory Satisfactory	\$8,000,000 \$8,000,000	\$13,750,000 \$13,750,000	\$7,493,750 \$6,187,500	\$15,493,750 \$14,187,500
(FY 1994) 10/1/93-3/31/94	85	Satisfactory	\$4,500,000	\$20,000,000	\$12,762,250	<u>\$17,262,250</u>
Total						<u>\$130,621,000</u>

* Adjective Rating terminology and Numerical Performance Score relationship changed beginning 10/01/90:

60 and below	Unsatisfactory
61-75	Marginal
76-85	Satisfactory (Good prior to 10-01-90)
86-95	Good (Excellent prior to 10-01-90)
96 and above	Outstanding

** Since the Statement of Work for Naval Fuels was deleted on October 1, 1991, we did not include Fixed Fees paid for Naval Fuels Materials Facility, in the amounts of: \$750,000 during FY 1989; \$1,500,000 during FY 1990; and \$124,000 during FY 1991.

APPENDIX III

SUMMARY OF WSRC TOTAL AVAILABLE FEE NEGOTIATIONS AND PAYMENTS DATA BY FISCAL YEAR (Dollars In Millions)

Fiscal Year	1989(a)	1990	1991	1992	1993	1994
Total Budget	765	1,501	2,054	2,017	2,127	1,822
<u>WSRC Initial Fee Proposal</u>						
Fixed-Fee-Equivalent (FFE)	6.0	70.0 (b)	24.4	61.6	66.0	39.0
No. of Fee Bases	?	Wtd.	?	54	61	19
		Guidelines				
Award Fee Split	25/150	(c)	50/100	50/100	50/100	33/134
Base Fee	1.5	70.0	12.2	30.8	33.0	13.0
Award Fee Pool	9.0	(c)	24.4	61.6	66.0	52.0
Total Available Fee	10.5	70.0	36.6	92.4	99.0	65.0
<u>SR "Negotiation Target" Fee</u>						
FFE from Fee Schedules	5.628	14.0	15.338	18.669	25.964	26.05
Adjustment Factor	-5%	+42%	+42%	+42%	+23%	-0-
Revised FFE	5.347	20.0	21.78	26.51	32.0	26.05
Number of Fee Bases	2	4	4	4	5	8
Award Fee Split	25/150	50/100	50/100	50/100	50/100	Various
Base Fee	1.337	10.0	10.9	13.0	16.0	5.241
Award Fee Pool	8.020	20.0	21.8	27.0	32.0	44.084
Total Available Fee	9.357	30.0	32.7	40.0	48.0	49.325
<u>Maximum Fee/DEAR (1 Fee Base/Schedule)</u>						
FFE	5.628	10.1	11.7	14.2	14.7	16.4
Number of Fee Bases	2	2	2	2	2	3 (d)
Award Fee Split (Actual)	25/150	50/100	50/100	50/100	54/92	31/138
Base Fee	1.407	5.05	5.85	7.1	7.938	5.084
Award Fee	8.442	10.10	11.70	14.2	13.524	22.632
Total Available Fee	9.849	15.15	17.55	21.3	21.462	27.716
<u>Final Negotiated Fee</u>						
FFE	5.0	20.0	21.75	26.5	29.75	29.0 (e)
Award Fee Split (Actual)	25/150	50/100	50/100	50/100	54/92	31/138
Base Fee	1.25	10.00	10.90	13.00	16.00	9.00
Award Fee Pool	7.50	20.00	21.70	27.00	27.50	40.00
Total Available Fee	8.75	30.00	32.60	40.00	43.50	49.00
<u>Total Fee Paid</u>						
Base Fee	1.250	10.000	10.900	13.000	16.000	4.500 (a)
Award Fee	3.938	13.750	13.020	17.820	13.680	12.762 (a)
Total Fee	5.188	23.750	23.920	30.820	29.681	17.262 (a)

(a) Six month period.
 (b) Fixed Fee rather than FFE.
 (c) Not applicable.
 (d) 1st year SR used "Construction Management" Maximum Fee Schedule.
 (e) "Effective" FFE reflecting higher award fee ratios; "Actual" FFE was \$26.05 million.

APPENDIX IV

ANALYSES OF TOTAL AVAILABLE FEE NEGOTIATIONS BY FISCAL YEAR

FY 1989 TOTAL AVAILABLE FEE NEGOTIATIONS

During May 1988, DOE received proposals from two companies, Martin Marietta Corporation (MMC) and Westinghouse Electric Corporation (Westinghouse), to manage and operate the Savannah River Site.

DOE Initial Procurement Actions

In July 1988, DOE's Source Evaluation Board was directed to conduct contract negotiations with both offerors, prior to the final contractor selection being made. It was believed that "significant advantage could be secured by DOE by conducting contract negotiations during the competitive source evaluation process." In August, both offerors delivered signed contracts to DOE, representing their best and final offers.

DOE's Initial Negotiation Actions

Upon receipt of these contracts, DOE entered into negotiations with both companies. Part of these negotiations involved establishing both a fixed-fee-equivalent and a total available fee for the initial six month contract period, beginning April 1, 1989, and extending through the remainder of FY 1989, which ended on September 30, 1989.

A direct comparison of MMC and Westinghouse fee proposals for this initial six month period cannot be made because each company proposed and negotiated fees on a different basis. Specifically, MMC negotiated a combined fee for itself and its three declared subcontractors. The final fixed-fee-equivalent negotiated for MMC, before conversion to an award fee basis, was \$6 million. WEC, on the other hand, negotiated a \$5 million fixed-fee-equivalent for WSRC, with negotiation of a fee for its one major subcontractor, BSRI, being deferred. Subsequent to WSRC's selection by DOE, WSRC negotiated, and DOE approved, a \$3.8 million fixed-fee-equivalent with BSRI. In addition to the above fees, MMC and Westinghouse each negotiated a \$750,000 fixed fee for the Naval Fuels Materials Facility.

DOE's Prenegotiation Fee Objective

Prior to negotiating fees with WEC for the initial six month period ending September 30, 1989, DOE's Source Evaluation Board established a fixed-fee-equivalent negotiation objective of \$5,346,914. This "target" fixed-fee-equivalent, developed by Savannah River Operations Office procurement personnel, was based upon the following key determinations:

- (1) The total budgeted dollars for the period were allocated among only two fee base segments, "Production" and "Research and Development."
- (2) All subcontracts in the fee bases, including BSRI, were discounted by 50 percent to more accurately reflect Westinghouse's actual management efforts.
- (3) The maximum fee schedules in DEAR 970.1509-5 were used to calculate the fixed-fee-equivalents for both the "Production" efforts and "R&D" efforts. These fees totaled \$5,628,330.
- (4) The total fixed-fee-equivalent calculated using steps 1-3 above was adjusted downwards by 5 percent to \$5,346,914, in accordance with the requirements of DEAR 970.1509-4(b), for the following five factors: management; complexity; resources; risk; and "other" factors.

In addition to the "target" fixed-fee-equivalent of \$5,346,914 to be used as the basis for an award fee, DOE also developed a second "target" fixed fee of \$1,225,766. This second amount, which was to remain a fixed fee, was for managing the Naval Fuels Materials Facility. This second fee, like the first, was calculated from the maximum fee schedules in DEAR 970.1509-5, and adjusted downwards by 5 percent.

WEC's FY 1989 Fee Proposal (6 months) and Subsequent Negotiations

Westinghouse submitted its fee proposal to DOE on July 28, 1988. It requested a fixed-fee-equivalent of \$6 million to manage and operate SRS for the six months ending September 30, 1989, broken down into a 25 percent base fee of \$1.5 million and a 150 percent award fee pool of \$9 million. It also requested a fixed fee of \$1.5 million to manage the Naval Fuels Materials Facility.

After negotiations with DOE, Westinghouse agreed to a fixed-fee-equivalent of \$5 million, to be broken down into a 25 percent base fee of \$1,250,000 and a 150 percent award fee pool of \$7,500,000, for a total available fee of \$8,750,000. Westinghouse further agreed to a fixed fee of \$750,000 for operating the Naval Fuels Materials Facility.

The \$5 million fixed-fee-equivalent Westinghouse accepted for FY 1989 was 11 percent less than the \$5,628,330 developed from the maximum fee schedules in DEAR 970.1509-5. The \$750,000 fixed fee accepted for the Naval Fuels Materials Facility was 42 percent less than the \$1,290,280 fee developed from the maximum fee schedules.

At the time these fees were being negotiated and accepted, Westinghouse was still in competition with Martin Marietta Corporation. DOE had not yet made a selection as to which contractor would manage and operate the Savannah River Site.

A summary of key data pertaining to the FY 1989 total available fee negotiations, as well as for FY 1990 through FY 1994 total available fee negotiations, is provided in Appendix III to the report.

FY 1990 TOTAL AVAILABLE FEE NEGOTIATIONS

On June 19, 1989, DOE's Savannah River Operations Office wrote to Westinghouse Savannah River Company, the Westinghouse Electric Company subsidiary now managing and operating the Savannah River Site, and requested its fee proposal for FY 1990. In this letter, SR stated that the fee proposal should be developed in accordance with DEAR 970.1509 and submitted no later than July 20, 1989.

WSRC's Initial FY 1990 Fee Proposal

On September 19, 1989, sixty days late, and less than six months after the start of the new contract, WSRC submitted its FY 1990 fee proposal to SR, requesting a fixed-fee-equivalent of \$70 million. WSRC had developed its fee request using a "weighted guidelines" approach, as described in DEAR 915.970-2. The total fee developed by WSRC using weighted guidelines was \$91.4 million; WSRC reduced this amount to \$70 million because of letter of credit funding and the use of government facilities.

WSRC's request for a \$70 million fixed fee, developed through a weighted guidelines approach, far exceeded the total fixed-fee-equivalent that could be supported by the

maximum fee schedules in DEAR 970.1509-5. WSRC's request was seven times as large as the annualized fixed-fee-equivalent the contractor had accepted for FY 1989, when competing against Martin Marietta Corporation. Use of weighted guidelines for management and operating contracts is specifically prohibited in DEAR 915.970-4. Furthermore, both the Request for Proposal (RFP) and the contract, which WSRC had signed the previous year, stated that fees would be determined in accordance with DEAR 970.1509.

In a letter accompanying its fee proposal, WSRC indicated that it had used weighted guidelines to develop its fee proposal because the fee schedules "no longer reflect the relationship between DOE and its contractors in light of the current atmosphere." The WSRC letter further discussed the increased risks to the contractor, increased demands upon corporate resources, and increased oversight activities resulting in adverse publicity.

On October 6, 1989, the Director of SR's Contracts and Services Division (i.e., Procurement) wrote DOE Headquarters Procurement and stated that, with the exception of Naval Reactors, Westinghouse had submitted weighted guidelines fee proposals for all its DOE M&O contracts, including those at Richland and Idaho. The Director further indicated that, since weighted guidelines for M&O contracts was prohibited by the DEAR, SR intended "to take no action toward fee negotiation with WSRC until guidance is provided from Headquarters."

SR's Initial FY 1990 Prenegotiation Fee Objective

On February 8, 1990, the Chief of SR's Contracts Management Branch, while indicating that firm guidance had still not been received from DOE Headquarters Procurement, submitted a prenegotiation plan for negotiating WSRC's FY 1990 fees. The Director of SR's Contracts and Services Division approved the plan that same day.

This prenegotiation plan established a total fixed-fee-equivalent negotiation objective of \$9,628,535. This amount was developed in essentially the same manner as the FY 1989 fee objective:

- (1) The SRS budget was divided into two fee base segments, "Production" and "R&D."
- (2) All subcontracts in the fee bases were reduced by 50

percent; the only exception, and the one change from FY 1989, being that Bechtel's "direct" efforts were reduced by only 35 percent. (Subcontractors supporting Bechtel efforts continued to be reduced by 50 percent.)

- (3) The fee schedules in DEAR 970.1509-5 were used to calculate the fixed-fee-equivalents for both "Production" and "R&D" efforts. These fees totaled \$10,135,300.
- (4) The total fixed-fee-equivalents calculated in steps 1-3 above were adjusted downwards by 5 percent to \$9,628,535, based upon DEAR 970.1509-4b.

During a review of SR's procurement files, we noted an unsigned, undated draft memorandum from SR's Deputy Assistant Manager for Administration to DOE Headquarters Procurement. This memorandum indicated that, after discussions with WSRC, SR was subsequently persuaded to reevaluate this initial fee objective, taking into consideration organizational changes by both SR and WSRC, as well as changes in operating requirements.

SR's Revised FY 1990 Prenegotiation Fee Objective

On March 28, 1990, the Director of SR's Contracts and Services Division submitted a revised FY 1990 fee objective to SR's Deputy Manager. The new objective set a \$14 million fixed-fee-equivalent, up from the previous amount of \$9.6 million. SR's Deputy Manager approved the \$14 million fee objective on the same day, March 28, 1990.

The most significant change in arriving at this revised fee objective involved splitting the one "Production" fee base in the previous estimate into three smaller "Production" fee bases, and calculating a separate fee for each fee base. Specifically, the previous estimate for "Production" effort was calculated on a fee base of \$1.158 billion, and provided a fee from the DEAR fee schedule of \$6.66 million. The revised estimate subdivided the "Production" effort into three separate fee bases as follows:

<u>Production Effort</u>	<u>Fee Base</u>	<u>Total</u>
	<u>(In Millions)</u>	<u>Fixed-Fee-Equivalent</u> <u>(In Millions)</u>
Site Operations	\$ 755	\$ 5.45
Reactor Restart	382	4.31
New Production		
Reactor	20	.85
Totals	\$1,157	\$10.61

The maximum fee schedules in DEAR 970.1509-5 are structured to provide declining fee percentages as the volume of the work increases; conversely, smaller work efforts carry higher fee percentages. Breaking a large work package (or effort) into smaller segments, and calculating a separate fee for each of the smaller segments, results in a larger total fee. By dividing the one fee base into three smaller segments, and calculating a separate fee for each, SR increased the total fixed-fee-equivalent for the "Production" effort by 59 percent, from \$6.66 million to \$10.61 million.

The other major revision to the earlier fee estimate involved elimination of the 5 percent reduction in the total fixed-fee-equivalent, previously made in accordance with DEAR 970.1509-4(b). This change added an additional \$700,000 to the revised estimate.

The breakout of the Reactor Restart and New Production Reactor segments from Site Operations was justified by SR due to "major changes since September 1988 in organizational alignment, both by DOE and WSRC, and in operating requirements" Three specific reasons for the new approach were cited by SR:

- (1) An unexpected shift of emphasis from reactor operations to reactor restart has caused DOE/SR to establish a separate project office and for WSRC to also set up a separate organization. This special effort was "not existing or contemplated at the time of contractor selection and contract award."
- (2) Both DOE/SR and WSRC have set up special offices to manage the New Production Reactor effort. "Again, this was a condition that did not exist at the time of the original negotiation."

(3) There has been a greater involvement of Westinghouse Electric Corporation corporate personnel than originally expected. "In addition, infusion of WEC personnel . . . has occurred at a rate much greater than expected."

We noted that many of the "major changes" cited as justification for increasing WSRC's FY 1990 fee calculation had been previously addressed in the original Request for Proposal in early 1988, and did not, in fact, represent actual changes in scope. Specifically, the description of work in the original RFP, and later in the contract, indicated that the contractor would be expected to "upgrade" facilities, and to manage programs ". . . intended to expand, alter, enhance, or improve the production of defense nuclear materials" [e.g., Reactor Restart.]

The RFP further stated "The SRP is a candidate site for the New Production Reactor (NPR). If the NPR is assigned to the SRP and if the Contractor is so directed by SR, the Contractor shall provide project management, design, and construction services for a reactor"

With respect to WSRC's reactor restart efforts, it is evident from a letter written by the then Secretary of Energy to the President of WEC in July 1989, less than four months after the start of the contract, that restarting reactors was a major discussion point during contract negotiations. The Secretary stated in his letter, in part:

"However, I am particularly disturbed that you did not find it sufficiently important to notify me personally that, in the last three months, Westinghouse had slipped the proposed restart date for the first reactor by nine months. The fact that Westinghouse would propose such a delay raises doubts about the validity of the assurance Westinghouse provided to the Department during the Savannah River contract award process and the personal assurances which you gave me during our previous discussions of this matter.

* * * * *

"The concerns I have expressed above regarding shortcomings in the Westinghouse plans for reactor restart should not be interpreted to mean that I expect a further schedule slippage.

. . . I am requesting that you become personally involved in this effort to assure that previous Westinghouse commitments to DOE with respect to the Savannah River Site are met."

Additionally, regarding the support being provided by WEC corporate personnel, WSRC's contract with DOE provided for reimbursement of WEC's costs for this support under special contract clauses. In addition to reimbursement of costs, WSRC's contract was also modified on September 19, 1989, to provide for separate fees to be paid on all Reactor Restart program support being provided by WEC divisions and subsidiaries.

DOE Negotiations with WSRC

On March 28, 1990, SR transmitted WSRC an offer for a total available fee for FY 1990 based on the \$14 million fixed-fee-equivalent. During the course of negotiations with WSRC, SR personnel revised their offer upwards to a fixed-fee-equivalent of \$15 million, coupled with an award fee split of 40/150 (which exceeded the guidelines in the DEAR regarding maximum award fee splits). SR increased its offer with the belief that this increase could bring the negotiations to a conclusion.

WSRC did not accept SR's offer, and subsequently made two counter proposals in writing on April 20, 1990. The first proposal was based on a fixed-fee-equivalent amount of \$22 million and an award fee split of 50/100. The second was based on a fixed-fee-equivalent of \$20 million and an award fee split of 40/150.

On April 30, 1990, the Director of SR's Contracts and Services Division provided SR's Deputy Assistant Manager for Administration with two draft documents for review: a Contracting Officer's determination to award WSRC a total available fee based on a \$15 million fixed-fee-equivalent with an award fee split of 40/150; and a request to Headquarters for Procurement Executive approval to exceed the fee schedules and maximum award fee guidelines. The Contracting Officer's draft determination made the statement that "Each of the . . . [WSRC] alternatives proposed fee amounts which continue to be considerably in excess of the amounts which SR considers to be reasonable within the guidelines of the DEAR fee policy for management and operating contractors."

In the course of preparing these documents, the Director of SR's Contracts and Services Division learned that WSRC had made two additional counter proposals, each based on a fixed-fee-equivalent of \$20 million, but with award fee splits of 50/120 and 40/120.

On May 24, 1990, SR senior management met with the Deputy and Associate Directors of DOE Headquarters' Office of Procurement and Assistance Management. SR had requested the meeting to seek approval to award WSRC a total available fee based upon a fixed-fee-equivalent which would exceed the DEAR's maximum fee schedules. SR indicated that the increased fee would be appropriate based upon:

- (1) The degree of Westinghouse corporate involvement;
- (2) The large infusion of Westinghouse corporate personnel into the WSRC organization;
- (3) Complexity and difficulty of the total contract task (e.g., reactor restart); and
- (4) WSRC's exposure to multiple oversight agencies and activities.

SR requested that the fixed-fee-equivalent amount, on which to establish the base and award fees, be increased to a total of \$20 million. This was \$6 million more than the \$14 million which SR had stated could be supported by application of the maximum fee schedules. Headquarters approved the request on May 29, 1990.

FY 1990 Fees Finalized

On June 4, 1990, eight months after the beginning of FY 1990, Modification M020 to the WSRC contract finalized WSRC's FY 1990 fees. Based upon a fixed-fee-equivalent amount of \$20 million and an award fee split of 50/100, WSRC was awarded a FY 1990 base fee of \$10 million and an award fee pool of \$20 million, for a total available fee of \$30 million. In addition, WSRC received a fixed fee of \$1.5 million for the Naval Fuels Materials Facility.

Instead of rendering the draft Contracting Officer's determination of fee based upon a fixed-fee-equivalent amount of \$15 million, SR essentially accepted WSRC's last offer based upon a \$20 million fixed-fee-equivalent, while adjusting the award fee split from 40/120 to 50/100. This \$20 million fixed-fee-equivalent was over twice as large as

the \$9.6 million maximum fixed-fee-equivalent originally approved by SR's Director of Contracts and Services Division in the February 8, 1990, prenegotiation plan.

DEAR 915.808, Price Negotiation Memorandum, requires that a post negotiation summary be prepared that "shall discuss the results of the negotiations leading to a final agreement, and, in a general sense, provide the results of the negotiation in terms of the extent to which prenegotiation objectives were met." SR has never prepared the required post negotiation summary for this \$31.5 million contract modification.

FY 1991 TOTAL AVAILABLE FEE NEGOTIATIONS

During June 1990, SR's Deputy Manager provided SR's Assistant Manager for Administration with guidance which was essentially used in developing WSRC's FY 1991 fee. In an inter-office memorandum, the Deputy Manager wrote "Let's calculate a fee for '91 just like we did the \$15 mil, then add the \$5 mil "kicker" adjusted on a pro-rata basis for any increase from the \$15 mil basic number. . . ."

On July 3, 1990, SR requested that WSRC submit a FY 1991 fee proposal by August 1, 1990. After an initial response on August 1, and subsequent clarification of several issues, WSRC presented SR with its FY 1991 fee proposal on September 13, 1990. This proposal requested a fixed-fee-equivalent of \$24.4 million with an award fee split of 50/100; WSRC further requested a fixed fee of \$131,000 for the Naval Fuels Materials Facility.

SR's FY 1991 Prenegotiation Fee Objective

On December 18, 1990, the Director of SR's Contracts and Services Division provided the SR Manager with a prenegotiation plan for WSRC's FY 1991 fees. The fee objective in this plan was developed in a manner almost identical to development of the FY 1990 fee. Specifically, the 1991 fee objective was based on the following key determinations:

- (1) In addition to the "R&D" effort, the "Production" effort was broken down into three separate fee bases: Site Operations, Reactor Restart, and New Production Reactor.

- (2) All subcontracts in the fee bases were discounted by varying percentages to more accurately reflect WSRC's actual management effort.
- (3) No downward fee adjustment factor was applied to the maximum fees calculated from the fee schedules.
- (4) The total fees from the maximum fee schedules (\$15.338 million) were adjusted upwards by the same percentage as used in FY 1990 (42 percent) to represent "the value of the special factors (WEC corporate involvement, infusion of WEC personnel into SRS [Savannah River Site], complexity of contract effort, and exposure to multiple oversight agencies)."

Based upon the above determinations, the Director of SR's Contracts and Services Division recommended that the FY 1991 total available fee be established using a fixed-fee-equivalent of \$21.78 million, and an award fee split of 50/100. In addition, a fixed fee negotiation target of \$124,000 was recommended for the Naval Fuels Materials Facility. The SR Manager approved the prenegotiation plan on December 21, 1990.

A draft memorandum from the SR Manager to the Assistant Secretary for Defense Programs discussed SR's past and current efforts to negotiate a fee with WSRC. In part, it stated:

"Last year's settlement required DOE to agree to a significant increase of almost 70% over the FY '89 annualized amount of \$17.5 million [total available fee] which was the initial fee negotiated with WSRC under the new contract effective 4/1/89. To justify last year's settlement, SR used every 'poetic license' available in the DOE Fee Curve regulations as well as adding an additional \$5 million to the CPFF [fixed-fee-equivalent] amount for 'factors' which were not appropriately addressed in the regulations such as degree of outside oversight, and extent of corporate and other Westinghouse involvement, etc. SR applied the same computational and 'factor' approach to an increased FY '91 budget in arriving at this year's number"

SR's prenegotiation plan stated that SR's fee objective had been coordinated with Headquarters Procurement. Unlike FY 1990, however, the required approval was not documented.

FY 1991 Fees Finalized

SR presented its fee position to WSRC on January 4, 1991. Based upon a fixed-fee-equivalent of \$21.78 million, SR offered WSRC a base fee of \$10.9 million (50 percent) and an award fee pool of \$21.7 million (100 percent), for a total available fee of \$32.6 million. Protracted negotiations then ensued, involving not only the fee, but also inclusion of a new DEAR award fee clause. In an April 23, 1991, letter, WSRC agreed to both SR's fee offer and inclusion of a new clause, "H.1 Award Fee," in their contract with DOE. Modification M034 was subsequently executed on June 4, 1991, to incorporate these agreements into the contract.

We noted that, by breaking the total FY 1991 "Production" fee base into three segments, SR obtained a \$3,687,000 (47 percent) increase in the calculation of the fixed-fee-equivalent, from \$7,776,000 to \$11,463,000. With a 42 percent add-on being applied to this \$3,687,000 increase for "special factors," the total increase in fee due to this splitting of the fee base was \$5,236,000. Furthermore, a fee calculated from the maximum fee schedules, using only one "R&D" fee base and one "Production" fee base and without any "add-on's", would have amounted to a fixed-fee-equivalent of \$11.65 million, or 53 percent of SR's \$21.78 million negotiated fixed-fee-equivalent.

FY 1992 TOTAL AVAILABLE FEE NEGOTIATIONS

On July 17, 1991, SR requested that WSRC submit a FY 1992 fee proposal by August 15, 1991; WSRC submitted its proposal on September 12, 1991.

WSRC's FY 1992 Fee Proposal

WSRC requested a fixed-fee-equivalent of \$61.6 million, and an award fee split of 50/100, providing a base fee of \$30.8 million, an award fee pool of \$61.6 million, and a total available fee of \$92.4 million.

WSRC's FY 1992 fee proposal illustrates the fee impact from dividing the total budget into smaller and smaller segments, and calculating a separate fee for each subdivision/fee base. In their proposal, WSRC divided the FY 1992 budget among 22 separate work packages, and then further subdivided

each work package into three separate components: "Production;" "Research and Development;" and "Construction Management." This breakdown potentially produced 66 separate fee bases; 54 had budgeted activity for which a separate fee was calculated by WSRC. The sum of these 54 separate fees, calculated using the maximum fee schedules, was a fixed-fee-equivalent of \$61.6 million.

WSRC's Revised FY 1992 Fee Proposal

On October 3, 1991, SR informed WSRC that their fee proposal was far in excess of what could be justified under the DEAR. SR stated that the fee conditions for FY 1992 were essentially unchanged from FYs 1990 and 1991, and requested WSRC to resubmit the proposal, consistent with DOE policies and regulations.

In a letter, dated December 5, 1991, WSRC defended the methodology used in developing its initial fee proposal. However, WSRC also stated that "In the spirit of attempting to reach an agreement for FY-92, we have made arbitrary reductions in the amount previously submitted." WSRC's new fee proposal was reduced to a fixed-fee-equivalent of \$30 million, split into a base fee of \$15 million and an award fee pool of \$30 million, for a total available fee of \$45 million. Four days later, WSRC also indicated to SR that they would like to discuss, along with the fee, a cost efficiency incentive program. Under this program, unearned award fee pool dollars could possibly be earned by completing specific cost reduction efforts.

SR's FY 1992 Prenegotiation Fee Objective

SR calculated its FY 1992 fee objective for WSRC in a manner identical to FY 1991. Specifically, the "Production" effort was broken down into the same three segments: Site Operations; Reactor Restart; and New Production Reactor. Subcontracts in the fee base were discounted by varying percentages. Also, the fees calculated from the fee schedules were again adjusted upwards by 42 percent, the same percentage applied in FYs 1990 and 1991. This upwards adjustment was to represent the value of "special factors" (WEC corporate involvement, infusion of WEC personnel into SRS, complexity of contract effort, and exposure to multiple oversight agencies).

SR calculated a fixed-fee-equivalent of \$18.669 million from the maximum fee schedules. Applying the 42 percent factor increased this amount by \$7.841 million, to a total

fixed-fee-equivalent of \$26.51 million. Using an award fee split of 50/100, SR's FY 1992 total available fee target was \$40 million (\$13 million base fee, \$27 million award fee pool).

In addition to the above fee, and at the suggestion of SR's Manager, SR also proposed a cost incentive fee not to exceed \$5 million. The incentive would be designed to reward WSRC for "hard dollar" cost savings. The source of funding for this cost savings incentive would be unearned award fee pool dollars carried over from the first six month evaluation period during FY 1992.

FY 1992 Fee Finalized

On January 28, 1992, SR wrote to DOE Headquarters Procurement confirming that a base fee/award fee pool amount of \$13 million/\$27 million (based on a fixed-fee-equivalent of \$26.51 million) had been proposed and accepted by WSRC. SR also requested approval to establish a cost savings incentive program with WSRC for FY 1992, not to exceed \$5 million. DOE Headquarters Procurement approved SR's request on February 13, 1992; the contract was subsequently modified (Modification M057) on June 5, 1992, to reflect these agreements.

We noted that, by splitting the "production" fee base into three segments, SR had once again, as in FYs 1990 and 1991, developed a fixed-fee-equivalent that exceeded the maximum fee schedules. This fact is readily apparent from SR's own documentation of its preparations for negotiating the FY 1992 fee. SR calculated various fee "options" using different methods and assumptions. One set of fee calculations was entitled "'standard' fee calculation" and used the maximum fee schedules to calculate a fee. Of particular interest, under this "standard" fee calculation, the "production" fee base was left intact, and not divided into three segments. The total fees calculated using this "standard" method were \$14.203 million, or 54 percent of the \$26.51 million fixed-fee-equivalent finally set as the prenegotiation target.

FY 1993 TOTAL AVAILABLE FEE NEGOTIATIONS

On August 6, 1992, SR requested that WSRC submit a FY 1993 fee proposal; WSRC submitted its fee proposal on August 27, 1992.

WSRC's FY 1993 Fee Proposal

In its fee proposal, WSRC requested a fixed-fee-equivalent of \$66 million. Using an award fee split of 50/100, WSRC further proposed a base fee of \$33 million and an award fee pool of \$66 million, for a total available fee of \$99 million.

WSRC had developed its proposed fee by allocating the FY 1993 budget among 31 separate work packages, and then subdividing each work package into three separate components: "Production;" "R&D/AE Design;" and "Construction Management/Construction." This breakdown potentially produced 93 separate fee bases; 61 had budgeted activity for which a separate fee was calculated by WSRC. The sum of these 61 separate fees, calculated using the maximum fee schedules, was a fixed-fee-equivalent of \$66 million.

In discussing the fee proposal, WSRC stated that, if DOE accepted its proposal, WSRC would be "willing to waive, for purposes of FY 1993 only, any claim to reimbursement of incentive compensation earned by its employees during the period." The elimination of employee incentive compensation as an allowable cost was one of the items being negotiated along with the FY 1993 fee. Other items also discussed by WSRC included modifications to the Personnel Appendix, a Task Order Contracting clause, plans for the "Accountability Rule," a Cost Reduction Incentive program, and a proposal to extend the WSRC contract through September 30, 1999.

WSRC's discussion of employee incentive compensation in its fee proposal was most likely the result of a letter from SR's Manager to WSRC, dated July 23, 1992. In this letter, SR's Manager stated that he had concluded that it was no longer in the best interests of the Government to recognize individual incentive award payouts as allowable costs under the prime contract.

On September 18, 1992, SR responded to WSRC's proposal, stating that WSRC's use of a task order/work package method for calculating its fee was inappropriate, resulting in a fee that was twice as large as the prior year. SR requested WSRC to resubmit its fee proposal based upon a total contract cost approach consistent with methods used in prior years. SR also indicated agreement with the WSRC approach of funding WSRC's employee incentive compensation program out of fee, rather than as a claimed cost.

SR's FY 1993 Prenegotiation Fee Objective

On October 9, 1992, SR requested DOE Headquarters approval to establish WSRC's FY 1993 fee based upon a fixed-fee-equivalent of \$32 million, with a 50/100 base fee/award fee split of \$16 million/\$32 million, for a total available fee of \$48 million.

SR pointed out to DOE Headquarters two changes from FY 1992 in developing this proposed fee. In discussing the first change, SR briefly stated that the budget had been broken into five categories for FY 1993 versus the four categories utilized in recent years. SR stated that this change was "to recognize the increased significance of the Environmental Restoration and Waste Management and DWPF [Defense Waste Processing Facility] Programs."

The second change, discussed by SR in greater length, concerned how much the fixed-fee-equivalent should be adjusted upwards to reflect the special factors of: (1) WEC corporate involvement; (2) infusion of WEC personnel into SRS; (3) complexity of contract effort; and (4) exposure to multiple oversight agencies. The fixed-fee-equivalent had been increased by 42 percent during FYs 1990 - 1992 to reflect these four factors; for FY 1993, SR proposed that the increase in fixed-fee-equivalent for these factors be limited to 26 percent (later recalculated at 23 percent).

The combined effect of these two changes was to increase the FY 1993 fixed-fee-equivalent calculated by SR over what it would have been had SR's FY 1992 method of calculation been used. Breaking the budget into five segments resulted in additional fee that more than offset the reduction of the upwards "adjustment" of the fixed-fee-equivalent from the 42 percent used in previous years down to 23 percent.

In calculating the FY 1993 fixed-fee-equivalent, SR eliminated the New Production Reactor as a fee base subdivision; this \$33 million "Production" fee base in FY 1992 had essentially ceased operations by FY 1993. Instead, SR substituted a new and much larger third "Production" subdivision, the \$425 million Environmental Restoration and Waste Management effort. In FY 1993, SR also broke out as a separate fee base the DWPF. This \$238 million effort, categorized as "Production" activity in previous years, was switched to "R&D" effort, concomitantly carrying a higher fee percentage. Specifically, SR calculated its proposed FY 1993 fixed-fee-equivalent from the maximum fee schedules as follows:

<u>Subdivision</u>	<u>Net Fee Base (In Millions)</u>	<u>Fixed-Fee-Equivalent Per Maximum Fee Schedules (In Millions)</u>
<u>Production</u>		
Site Operations	\$657	\$6.217
Reactors	423	5.259
Environmental Restoration	425	5.264
<u>Research & Development</u>		
Savannah River Laboratory	177	4.718
DWPF	<u>238</u>	<u>5.189</u>
Totals	\$1,920	\$26.647
	<u>=====</u>	<u>=====</u>

SR then: (1) reduced this \$26.647 million fixed-fee-equivalent by \$683,000 to reflect a 35 percent reduction in the fee base for the Bechtel subcontract; and (2) increased the fixed-fee-equivalent by \$6,036,000 to reflect the 23 percent upwards "adjustment" for the four special factors. This resulted in the total proposed fixed-fee-equivalent of \$32 million.

We noted that the impact of changing the fee base structure in FY 1993 was to increase the fixed-fee-equivalent by \$7,737,000, from \$18,227,000 to \$25,964,000. After applying the 23 percent upwards "adjustment" factor to the \$7,737,000, the dollar impact increased to \$9,517,000. Reduction in the upwards adjustment of the fixed-fee-equivalent, from 42 percent in FY 1992 down to 23 percent in FY 1993, on the other hand, reduced the fee calculation by only \$4,933,000. Thus, the net effect of the FY 1993 changes was a \$4,584,000 increase in the fixed-fee-equivalent.

We further noted that, had the fixed-fee-equivalent been calculated in the same manner as in the beginning of the contract (as shown in the following table), with one "Production" fee base, one "R&D" fee base, and DWPF classified as "Production" effort, the total fixed-fee-equivalent would have been \$14,704,000, or 46 percent of the \$32 million fixed-fee-equivalent SR was proposing to DOE Headquarters. The \$14,704,000 was calculated as follows:

<u>Subdivision</u>	<u>Net Fee Base (In Millions)</u>	Fixed-Fee-Equivalent Per Maximum Fee
		<u>Schedules (In Millions)</u>
<u>Production</u>		
Site Operations	\$ 657	\$
Reactors	423	
Environmental Restoration	425	
DWPF	<u>238</u>	
	1,743	10.670
<u>Research & Development</u>		
Savannah River Laboratory	<u>177</u>	<u>4.718</u>
		15.387
Less Fee Reduction for Bechtel Subcontract		<u><.683></u>
Totals	<u>\$1,920</u>	<u>\$14.704</u>

Based upon this analysis, we believe that SR should have been writing DOE Headquarters Procurement to justify fees of 118 percent, rather than 23 percent, above the maximum fee schedules.

After SR submitted its \$48 million total available fee proposal to DOE Headquarters Procurement, discussions ensued between SR and Headquarters officials. The outcome of these discussions, according to the Chief of SR's M&O Contractor Oversight Branch, was that DOE Headquarters set the limit on DOE's total available fee offer to WSRC at \$43.5 million. On November 11, 1994, SR subsequently communicated to WSRC an offer of \$16 million base fee/ \$27.5 million award fee pool, for a total available fee of \$43.5 million.

FY 1993 Fee Finalized

After further discussions between SR and WSRC, a letter of agreement was signed on December 24, 1992. This agreement established a \$16 million base fee/\$27.5 million award fee pool for FY 1993, based upon a fixed-fee-equivalent of \$29.75 million. The letter also documented nine additional agreements, to include a cost reduction incentive program for a one year trial period and the elimination of incentive compensation paid in FY 1993 as an allowable cost.

On March 19, 1993, Modification M068 to the WSRC contract was executed, formalizing the agreements reached in the December 24, 1992, letter. This modification also revised the Personnel Appendix to WSRC's contract, to state: "No incentive compensation payments are authorized as allowable costs for CY 1992 performance [paid in FY 1993] of exempt employees. Future incentive compensation payments will only be allowable if they are made in accordance with a plan approved in advance by the Contracting Officer."

Although required by DEAR 915.808, SR had not, at the conclusion of our inspection fieldwork, prepared the price negotiation memorandum for this \$43.5 million contract modification, which would normally document both the basis of the prenegotiation fee objectives and the extent to which these objectives were met.

Impact of Incentive Compensation on FY 1993 Fee

We discussed the \$3 million increase in WSRC's base fee from FY 1992 to FY 1993 (from \$13 million to \$16 million), and the \$500,000 increase in award fee pool (from \$27 million to \$27.5 million) with management officials of both SR and WSRC. Officials from both organizations stated that the increase in FY 1993 total available fee was, in part, due to WSRC now having to absorb the cost of employee incentive compensation as an unallowable cost.

An earlier unsigned SR internal document to SR's Manager, dated October 6, 1992, which we noted in SR's procurement files, had discussed the possible role of fee as a method of indirectly funding WSRC employee incentive compensation costs, while avoiding claims by WSRC for employee incentive compensation as an allowable cost under the contract. This document stated, in part:

"-- there are two ways WSRC can recover IC [incentive compensation] costs: through fee or as an allowable cost. I would prefer the fee approach as this would exclude any DOE involvement in the process."

* * * * *

"-- For '93, we believe that by splitting out EM [Environmental Restoration and Waste Management] into a separate fee base and continuing the calculational approach used in the last two years, we may be able to get to a

fixed fee of \$16MM and an award fee of \$32MM for a total of \$48MM. Additionally we will be giving them the 'open-ended' hard savings program recently approved by S-1. . . .

"- The above would, in my mind, provide more than enough in additional fixed fee to cover the cost of the IC program [\$2.7MM last year] and an additional amount to reflect something for Task order contracting. The formal record would not show that we have done either! . . .

"I recommend we proceed with trying to get HQ concurrence to our fee option."

Prior to signing Modification M068, WSRC indicated to SR that the issue of additional fee in exchange for absorbing the cost of an employee incentive compensation program was not going to end with the FY 1993 fee. In a January 28, 1993, letter to SR's Assistant Manager for Administration, WSRC's General Counsel wrote:

"Our agreement is that WSRC will make no claim for incentive compensation paid during FY-93. Since Clause I.73 DEAR 970.5204-13 ALLOWABLE COSTS AND FEES (COST REIMBURSEMENT MANAGEMENT AND OPERATING CONTRACTS) (DEVIATION) (AUG 1988) provides that incentive compensation is an allowable cost, WSRC reserves the right to charge incentive compensation paid in future years to the contract unless other agreements are reached."

FY 1994 TOTAL AVAILABLE FEE NEGOTIATIONS

On July 8, 1993, SR requested that WSRC submit a FY 1994 fee proposal which would be innovative and motivate WSRC to achieve various Departmental objectives. SR requested this proposal by September 1, 1993.

WSRC's FY 1994 Fee Proposal

On October 14, 1993, WSRC submitted its FY 1994 fee proposal to SR. In its proposal, WSRC divided the total budget into ten discrete packages. Each of these ten packages was then further divided, where appropriate, among three components: (1) "Production;" (2) "R&D/AE Design;" and (3) "Construction Management/Construction." Each of these components was

treated as a separate fee base, and a fee was calculated from the appropriate maximum fee schedules within the DEAR. Out of the 30 possible fee bases (ten packages with three components each), 19 had budgeted activity on which fees were calculated, producing a total fixed-fee-equivalent of \$39 million.

WSRC further proposed that this \$39 million fixed-fee-equivalent be converted into a base fee of \$13 million and an award fee pool of \$52 million, for a total available fee of \$65 million. Rather than applying a common award fee split, such as 50/100, across all work packages, WSRC proposed varying splits of 50/100, 25/150, and 0/200. All of these proposed splits conformed to options within the DEAR. WSRC's stated intention was to place more of its fee at risk (e.g., 0/200) in areas it judged to be most critical to the Department's mission. In addition, WSRC identified four special initiatives for which, if not achieved, WSRC would forfeit various amounts of fee, totaling \$2.2 million overall.

Finally, WSRC stated in its proposal that "The fee figures do not include or consider in any way the treatment of FY94 incentive compensation as anything but an element of allowable cost."

Development of SR's FY 1994 Offer

On December 3, 1993, SR's Manager was briefed regarding WSRC's proposal. SR's Manager made a decision to adopt WSRC's approach of allocating fee among ten areas of performance, and to vary the award fee split ratios in order to increase the fee risk in key areas to the contractor. SR also decided to request DOE Headquarters permission to establish WSRC's FY 1994 total available fee at the same level as FY 1993. The FY 1993 total available fee was based on a fixed-fee-equivalent of \$29.75 million, and split up into a base fee of \$16 million and an award fee pool of \$27.5 million. SR noted in their briefing charts that the \$16 million base fee included a \$3 million allowance for Incentive Compensation.

On December 9, 1993, SR management met with DOE Headquarters officials and presented the fee concept proposed by WSRC, along with its own recommendation for establishing the FY 1994 fee based upon a fixed-fee-equivalent of \$29.9 million, versus the FY 1993 fixed-fee-equivalent of \$29.75 million. One of the concerns expressed at this meeting was that SR's proposed fee did not properly reflect the budget decline.

With an approximate 10 percent decrease in the FY 1994 budget, DOE officials thought WSRC's fee should also have declined from FY 1993 levels. The outcomes of this meeting included SR's agreement to recalculate the fixed-fee-equivalent to reflect the decline in budget. It was also reaffirmed at the meeting that "the FY93 \$3M [million] buyout of incentive compensation will continue in FY94 and future years."

SR subsequently developed a fee proposal based upon a fixed-fee-equivalent of \$26.050 million. SR spread this fee over the ten tasks proposed by WSRC using award fee split ratios varying among 0/200, 10/180, 25/160, 25/165, 30/150, and 30/160. The combined effect of these ratios resulted in an overall award fee ratio of 20/169, resulting in a base fee of \$5.241 million and an award fee pool of \$44.084 million, for a total available fee of \$49.325 million. After receiving DOE Headquarters approval for this proposal, SR presented it to WSRC on December 22, 1993.

In January 1994, further discussions took place between SR and WSRC regarding the allocation of base fee and award fee pool, and the restructuring of the award fee curve (i.e., the percent of award fee pool earned for various performance scores). Negotiations culminated with agreement on a base fee of \$9 million, an award fee pool of \$40 million, and a revised award fee curve. SR verbally received DOE Headquarters approval on March 11, 1994, and Modification M093, incorporating this agreement into the contract, was executed on April 8, 1994.

Award Fee Ratios

In previous years, the award fee split ratios did not exceed maximums specified in DEAR 970.1509-8. Specifically, the award fee pool did not exceed twice the fixed-fee-equivalent, after the base fee was deducted. As further explanation, expressed in percentages, if the base fee were set at 40 percent of the fixed-fee-equivalent, the maximum award fee, per the DEAR guidelines, would be set at twice the remaining fixed-fee-equivalent (twice 60 percent, after the 40 percent base fee was deducted), or 120 percent of the fixed-fee-equivalent. The ratio in this instance would be expressed as 40/120. For 1994, however, SR negotiated ratios that frequently exceeded these DEAR maximums, as the following table indicates:

<u>Negotiated Ratios</u>	<u>Conforming Ratios per DEAR</u>
0/200	0/200
34/162	34/132
36/154	36/128
40/140	40/120
50/126	50/100
50/135	50/100
65/112	65/70

For FY 1994, the negotiated fee was ostensibly based on a fixed-fee-equivalent of \$26,050,000. WSRC's total available fee for FY 1994, however, actually represented a fixed-fee-equivalent of \$29 million (\$9 million base fee and one-half of the \$40 million award fee pool). This assertion is based on the guidelines reflected in the maximum potential award fee schedule in DEAR 970.1509-8(d), which establishes maximum potential award fee pools at twice the amount of the fixed-fee-equivalent allocated to the pool. In effect, a fixed-fee-equivalent dollar is converted into two award fee pool dollars, or vice-versa. Applying this ratio, WSRC's \$40 million award fee pool is the equivalent of \$20 million in fixed-fee-equivalent.

This effective increase in the fixed-fee-equivalent, from \$26.05 million to \$29 million, was achieved by assigning award fee split ratios that exceeded the guideline ratios (1:2) in the DEAR, thereby increasing the award fee pool. It is further noted that this \$3 million effective increase in the fixed-fee-equivalent corresponds with the \$3 million identified by SR as necessary to fund WSRC's unallowable employee incentive compensation program.

FY 1994 Fee Bases

In calculating the \$26,050,000 fixed-fee-equivalent for FY 1994, SR broke the budget into eight segments as shown below:

(Continued on next page)

<u>Subdivision</u>	<u>Net Fee Base (In Millions)</u>
<u>Production</u>	
Site Operations	\$ 687
Environmental Restoration and Waste Management	346
Savannah River Technology Center	45
<u>Research and Development</u>	
Defense Waste Processing Facility	155
Savannah River Technology Center	110
<u>Construction Management</u>	
Site Operations	164
Savannah River Technology Center	66
Defense Waste Processing Facility	44
Total	\$1,617
	<u> </u>

It should be noted that a portion of the Savannah River Technology Center's budget was included in "Production" activity. FY 1989 was the last time SR had identified "Production" activity within this organization's operations. If the FY 1994 budget were broken into the three fee categories of Production, R&D, and Construction Management, and the Defense Waste Processing Facility was reclassified as a "Production" activity, as done for FY 1989, then the maximum fees from the DEAR fee schedules would have totaled \$16,396,000. By splitting its budget into eight separate fee bases, SR increased the calculation of fixed-fee-equivalent by \$9,654,000, or 59 percent, to \$26,050,000.

ATTACHMENT A

MAXIMUM FEE SCHEDULES
Per DEAR 970.1509-5
Effective Prior to June 19, 1991

PRODUCTION EFFORTS

Fee Base	Fee	Fee (Percent)	Increment (Percent)
Up to \$1 million....	7.00	7.00
1,000,000.....	\$70,000	7.00	6.05
3,000,000.....	191,000	6.37	5.25
5,000,000.....	296,000	5.92	4.18
10,000,000.....	505,000	5.05	3.50
15,000,000.....	680,000	4.53	3.30
25,000,000.....	1,010,000	4.04	2.86
40,000,000.....	1,439,000	3.60	2.41
60,000,000.....	1,921,000	3.20	2.07
80,000,000.....	2,335,000	2.92	1.50
100,000,000.....	2,635,000	2.64	1.10
150,000,000.....	3,185,000	2.12	.60
200,000,000.....	3,485,000	1.74	.50
300,000,000.....	3,985,000	1.33	.40
400,000,000.....	4,385,000	1.10	.30
500,000,000.....	4,685,000	.94	
Over 500M.....	4,685,000	1/ +.30	

1/ Excess

MAXIMUM FEE SCHEDULES Per DEAR 970.1509-5
Effective Prior to June 19, 1991

RESEARCH AND DEVELOPMENT EFFORTS

Fee Base	Fee	Fee (Percent)	Increment (Percent)
\$25,000.....	\$2,500	10.00	9.74
50,000.....	4,938	9.87	8.97
100,000.....	9,420	9.42	8.22
200,000.....	17,640	8.82	7.64
400,000.....	32,920	8.23	7.28
600,000.....	47,480	7.91	6.92
800,000.....	61,320	7.67	6.69
1,000,000.....	74,700	7.47	6.38
3,000,000.....	202,300	6.74	6.11
5,000,000.....	324,500	6.49	5.53
10,000,000.....	601,000	6.01	4.82
15,000,000.....	842,000	5.61	4.15
25,000,000.....	1,257,000	5.03	3.60
40,000,000.....	1,797,000	4.49	3.10
60,000,000.....	2,417,000	4.03	2.40
80,000,000.....	2,897,000	3.62	1.88
100,000,000.....	3,273,000	3.27	1.12
150,000,000.....	3,833,000	2.56	.65
200,000,000.....	4,158,000	2.08	.55
300,000,000.....	4,708,000	1.57	.45
400,000,000.....	5,158,000	1.29	.35
500,000,000.....	5,508,000	1.10	
Over 500M.....	5,508,000	1/ +.35	

1/ Excess

ATTACHMENT B

MAXIMUM FEE SCHEDULES Per DEAR 970.1509-5
Effective June 19, 1991

PRODUCTION EFFORTS

Fee Base (dollars)	Fee (dollars)	Fee (Percent)	Increment (Percent)
Up to \$1 million....	7.00
1,000,000.....	\$70,000	7.00	6.20
3,000,000.....	194,000	6.47	5.55
5,000,000.....	305,000	6.10	4.48
10,000,000.....	529,000	5.29	3.88
15,000,000.....	723,000	4.82	3.39
25,000,000.....	1,062,000	4.25	3.06
40,000,000.....	1,521,000	3.80	2.67
60,000,000.....	2,054,000	3.42	2.35
80,000,000.....	2,524,000	3.16	2.14
100,000,000.....	2,952,000	2.95	1.32
150,000,000.....	3,613,000	2.41	1.02
200,000,000.....	4,123,000	2.06	0.56
300,000,000.....	4,678,000	1.56	0.48
400,000,000.....	5,162,000	1.29	0.41
500,000,000.....	5,574,000	1.11
Over 500M.....	5,574,000	<u>1/</u> 0.41

1/ 0.41% excess over \$500 million.

MAXIMUM FEE SCHEDULES
 Per DEAR 970.1509-5
 Effective June 19, 1991

RESEARCH AND DEVELOPMENT EFFORTS

Fee Base (dollars)	Fee (dollars)	Fee (Percent)	Increment (Percent)
25,000.....	2,500	10.00	10.00
50,000.....	5,000	10.00	10.00
100,000.....	10,000	10.00	8.00
200,000.....	18,000	9.00	8.00
400,000.....	34,000	8.50	7.50
600,000.....	49,000	8.17	7.00
800,000.....	63,000	7.88	7.00
1,000,000.....	77,000	7.70	6.40
3,000,000.....	205,000	6.83	6.25
5,000,000.....	330,000	6.60	5.68
10,000,000.....	614,000	6.14	5.22
15,000,000.....	875,000	5.83	4.43
25,000,000.....	1,318,000	5.27	3.86
40,000,000.....	1,897,000	4.74	3.38
60,000,000.....	2,572,000	4.29	2.99
80,000,000.....	3,170,000	3.96	2.46
100,000,000.....	3,662,000	3.66	1.54
150,000,000.....	4,434,000	2.96	1.04
200,000,000.....	4,955,000	2.48	0.61
300,000,000.....	5,561,000	1.85	0.53
400,000,000.....	6,095,000	1.52	0.46
500,000,000.....	6,556,000	1.31
Over \$500M.....	6,556,000	<u>1/0.46</u>

1/ 0.46% excess over \$500 million.

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