EMERGENCY TRANSPORTATION SERVICES CONTRACT: LESSONS LEARNED FROM THE 2005 GULF COAST HURRICANES

Office of the Secretary

Report Number: FI-2007-030
Date Issued: February 5, 2007

U.S. Department of Transportation
Office of the Secretary of Transportation
Office of Inspector General

Memorandum

Subject: ACTION: Report on Emergency Transportation Services Contract: Lessons Learned From the 2005 Gulf Coast Hurricanes, OST
Report No. FI-2007-030

Date: February 5, 2007

From: Rebecca C. Leng
Assistant Inspector General for Financial and Information Technology Audits

Reply to Attn. of: JA-20

To: Acting Director, Office of Intelligence, Security, and Emergency Response

This report presents the results of our review of Federal Aviation Administration (FAA) actions in modifying the Department of Transportation's (DOT) emergency transportation services contract for Hurricane Katrina, and, more broadly, contracting issues dealing also with Hurricanes Rita and Wilma. Designing and administering contracts for emergency transportation services is particularly difficult because it compels acquisition officials to anticipate requirements based upon the consequences of natural and man-made disasters. Even with the best of planning, disasters can cause unprecedented challenges and unforeseen events to which officials must respond.

In the immediate aftermath of disasters, it is often impossible—in the midst of the devastation—to determine the full extent and intensity of the damage in order to initiate remedial action. Although it is critical that officials act immediately in response to a disaster, they must still do all they can to ensure that contracts are properly administered and that prices for emergency services are reasonable. Reasonable prices are vital to stimulating efficient contractor performance while providing appropriate rewards for the risks that they assume.

Under the Federal Government's National Response Plan, DOT is responsible for coordinating and providing Federal and civil transportation support during national emergencies, as directed by the Federal Emergency Management Agency and other Federal agencies. Within DOT, the Office of Intelligence, Security, and Emergency Response coordinates these efforts. To support the Department's responsibilities, FAA's Southern Region awarded a competitive contract on an indefinite delivery, indefinite quantity basis to Landstar Express America, Inc. in 2002 to provide air, sea, and land transportation and associated services during national emergencies. Upon contract activation, personnel at FAA's Southern Region performed the contract administration duties.

In the aftermath of Hurricane Katrina, the immediate transportation of people and vital supplies to and from hurricane-affected areas was critical to saving lives. The circumstances surrounding the disaster were extraordinary, and FAA Southern Region management and its contractor provided an unprecedented response to the crisis as it unfolded. In 2003, during Hurricane Isabel, DOT transported about 700 truckloads of commodities to support areas affected by that storm. In contrast, in 2005, DOT transported about 23,000 truckloads of commodities in response to Hurricanes Katrina, Rita, and Wilma—over 30 times the volume of 2003. To respond to the requirement for an increased volume of services, the contract was modified, increasing the cap from $100 million to $400 million for calendar year 2005, with up to an additional $100 million added for calendar year 2006.

Our objective was to determine what lessons relating to contract design and administration could be learned from this disaster and FAA's response to it. We performed this audit in accordance with Generally Accepted Government Auditing Standards as prescribed by the Comptroller General of the United States and conducted such tests as we considered appropriate to detect fraud, abuse, or illegal acts. See Exhibit A for a full explanation of our scope and methodology.

RESULTS IN BRIEF

FAA Southern Region's emergency transportation services contract successfully allowed FAA and its contractor to carry out a strong, rapid response during the 2005 Gulf Coast hurricanes. Having an existing competitive contract in place limited cost risks while at the same time ensuring that transportation services that were essential in such catastrophic conditions were made available.

However, this disaster also provided lessons about how contracting practices can be improved. FAA Southern Region personnel told us that contract administration resources were stretched quite thin and, understandably, that the top priority was to provide transportation to deliver goods, equipment, and services as quickly as possible to those in need of assistance.

Nevertheless, these experiences demonstrate that, when possible, it is important to ensure that:

- Administrative costs are properly structured and adaptable to unforeseen and changing requirements,
- The profit rate paid to contractors does not exceed 10 percent,
- Contracts are effectively administered, and
- Price reasonableness determinations are periodically performed.

DOT has already taken steps to begin dealing with these issues. For example, the contracting officer began requesting updated subcontractor quotes for task orders on February 28, 2006. This practice resulted in better pricing.

To strengthen future emergency contracts, we recommended that the Office of Intelligence, Security, and Emergency Response ensure that administrative fees are structured appropriately and that profit rates are appropriate for the types of contracts awarded and in accordance with sound business practices.

We provided the Office of the Secretary of Transportation (OST) with a copy of our draft report on December 22, 2006. On January 19, 2007, OST provided its formal response. OST agreed with our findings and recommendations. OST's planned corrective actions are responsive, subject to follow-up provisions in DOT Order 8000.1C. Our recommendations and a summary of OST's response can be found on pages 6 and 7 of this report.

Additionally, in its response, OST stated that FAA's Southern Region has secured Landstar's promise to negotiate, in good faith, changes to profit and administrative fee rates in the present contract. We request that OST provide us with the revised profit and administrative fee rates and associated cost savings, if any. OST's response is contained in its entirety in the Appendix.

FINDINGS

Improving the Structure of Administrative Costs

Improving the structure of the administrative fee established for the contract and the modification to the contract would better protect the Government's interests. FAA established the administrative fee as a fixed rate, which inappropriately included both fixed and variable expenses. Unlike variable expenses, fixed expenses by nature do not fluctuate with changes in work requirements. Using a single fixed rate to reimburse the contractor—comprising both types of expenses—increases the Government's vulnerability to overpaying.

Under this scenario, the Government pays more in administrative costs if the costs incurred by the contractor increase. For future contracts, the fixed administrative rate structure should be revised to either (1) exclude fixed expenses from the fixed rate and pay for them separately or (2) pay for the contractor's actual administrative costs incurred. Structuring a fee in this manner helps ensure that the Government is paying fair and reasonable prices.

Limiting Contractor Profit

Since profit is the contractor's reward for assuming the risks and burdens associated with a contract, a contract's profit rate, in general, should be commensurate with the risk of not recovering the costs that the contractor bears. For cost–plus–fixed–fee contracts, the contractor assumes minimal risk of not recovering costs. Therefore, the profit rate determination—both for the base contract and the modification—should reflect that minimal risk.

The profit rates for FAA's contract (including the modification) were as high as 15 percent. This exceeds the maximum rate allowed by the Federal Acquisition Regulation (FAR). While the FAR limits profit on cost-plus-fixed-fee type contracts to 10 percent, FAA's acquisition policy sets no limit on profit. We recognize that FAA is not subject to FAR requirements, as are other DOT Operating Administrations and other Federal agencies. However, paying more profit than what is allowed by other DOT Operating Administrations and Federal agencies without good reason is not a sound business practice. To illustrate the extent to which FAA paid its contractor over the 10 percent generally accepted rate, of the 571 task orders issued under this contract in response to Hurricane Katrina, we reviewed 11 randomly selected orders that had a total value of about $27 million. About $3 million of that amount was profit. Had the profit rate been limited to 10 percent for these 11 task orders, the Government could have avoided paying over $565,000 (see Exhibit B).

Effective Contract Administration

FAA awarded task orders on this contract on a cost-plus-fixed-fee basis. This method is designed to reimburse the contractor for profit at fixed amounts. However, the contract was not administered in this way. Instead of establishing profit amounts for each task order before the work started, FAA allowed the amounts to remain uncertain until work was substantially completed. Administering a contract in this manner results in the application of a cost-plus-percentage-of-cost contract, which is prohibited by FAA acquisition policy. These contracts offer no incentive for contractors to control costs because their profits increase in direct proportion to the costs of services performed.

For example, while FAA authorized the use of 100 water tankers on September 6, 2005, it did not concurrently issue a task order establishing a fixed-fee amount that the contractor would be paid. It was not until November 14th that FAA issued the task order. The delay essentially changed the character of the contract from cost-plus-fixed-fee to cost-plus-percentage-of-cost because, rather than setting the amount before work commenced, the fixed-fee amount was set after the work had been substantially completed. This type of arrangement provides an incentive for the contractor to overspend because as the total cost increases, so does the fee.

FAA procurement officials discontinued the practice in October 2005 and formalized the procedures in March 2006. We verified that task orders issued since then were administered properly. An FAA contracting official stated that administering the contract as a cost-plus-percentage-of-cost contract was a consequence of FAA Southern Region's being overtasked by the unprecedented level of response needed as a result of Hurricane Katrina's devastation.

Determining Price Reasonableness

FAA's acquisition policy requires that current quotes and pricing information be obtained for each task order modification. However, contracting officials did not regularly require that the contractor provide revised subcontractor quotes when task orders were modified for services not included in the original task order or when the performance period was extended. FAA officials eventually took corrective action by requesting updated subcontractor quotes, and considerably lower prices were negotiated.

For example, on September 2, 2005, the contractor provided FAA with subcontractor quotes for four refrigerated trucks with power supplies. FAA awarded a task order for the trucks at a value of $120,481. Over time, FAA modified the task order by more than a factor of 10—to a value of $1,372,370—to increase service and extend the period of performance by an additional 10 months. FAA awarded these task order modifications without requiring that the contractor again provide FAA with subcontractor quotes, in direct contravention of FAA's own acquisition policy and contract terms.

To illustrate the extent of this problem, we reviewed nine judgmentally selected task orders to identify instances in which the initial scope of work was modified. We found that significant modifications occurred for three of the nine task orders and that the contractor did not provide updated subcontractor quotes. Beginning in February 2006, FAA obtained new subcontractor quotes for modifications awarded for the three orders. Based on the three orders we reviewed, FAA could have avoided paying over $273,000 had contracting officials obtained the updated quotes sooner.[1] Exhibit C provides details on how we calculated the cost avoidance.

Again, the stretching of FAA Southern Region's resources to provide the unprecedented level of response was the cause of the Agency's not obtaining current pricing sooner for the modifications.

FAA Has Initiated Corrective Action

During the audit, FAA officials ensured that fixed fees were awarded before beginning work on task orders. Further, on its own initiative, FAA began obtaining updated subcontractor quotes for task orders modified on or after February 1, 2006, resulting in better pricing. For example, for one task order, the updated contractor proposal showed a reduction in subcontractor quotes by $350 per day per truck—a 25-percent reduction from previous daily rates. This resulted in savings of $76,160. Accordingly, we are not making any recommendations in these areas. DOT officials are coordinating with FAA on how to better structure DOT's future emergency transportation contract, including using more flexible contract terms, such as providing that indirect rates be cost-reimbursable and subject to annual audits.

RECOMMENDATIONS

In order to strengthen future emergency transportation contracts, we recommend that the DOT Acting Director, Office of Intelligence, Security, and Emergency Response:

1. Ensure that administrative fees are structured appropriately for future emergency contracts.

2. Negotiate profit rates for future emergency contracts that are appropriate for the types of contracts awarded and in accordance with sound business practices.

[1] In assessing task order modifications, we limited our analysis to modifications made more than 120 days after award of the task order. The original task orders were awarded shortly after August 29, 2005—the date that Hurricane Katrina struck. In our opinion, such a significant lapse from the time between the orders and later modifications should have triggered a concern that conditions—such as initial demand—might have changed, which should have resulted in lower unit prices.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

A draft of this report was provided to OST on December 22, 2006. On January 19, 2007, OST provided its formal response, which is contained in its entirety in the Appendix. OST agreed with our findings and concurred with our recommendations. OST indicated that while the Landstar contract provided a useful mechanism to expedite transportation services in response to the unprecedented devastation of that year's Gulf Coast hurricanes, post event analyses, including those by the Office of the Inspector General, have identified areas where improvements can be achieved. OST intends to address those areas both during the ongoing recompetition for the next emergency transportation services contracts and in further administration of the present contract.

Management responses to our recommendations are summarized below.

Recommendation 1: OST concurred. The Department has ongoing efforts directed towards completing the next emergency transportation services contract. During this contracting effort, the Department will assess the administrative fee structures with the intention of providing a fee structure in the new contract that helps to ensure that the Federal government is paying fair and reasonable prices. The Department intends to complete the contracting effort before the end of fiscal year (FY) 2007. Also, OST indicated that the FAA Southern Region has secured Landstar's promise to negotiate in good faith changes to profit and administrative fee rates in the present contract.

Recommendation 2: OST concurred. During the ongoing contracting process for the next emergency transportation services contract, DOT will ensure that any negotiated profit rates are appropriate for the risk inherent in the type of contract proposed and consistent with applicable regulations. The Department intends to complete the contracting effort before the end of FY 2007.

ACTIONS REQUIRED

The actions planned satisfy the intent of our recommendations, subject to follow-up provisions in DOT Order 8000.1C. We request that OST provide us with the revised profit and administrative fee rates and associated cost savings, if any, resulting from negotiations with Landstar in the present contract.

We appreciate the courtesies and cooperation of Department of Transportation representatives during this audit. If you have any questions concerning this report, please call me or Mark H. Zabarsky, Deputy Assistant Inspector General for Financial Management Audits, at (202) 366-1496.

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cc: Assistant Secretary for Budget
and Programs/Chief Financial Officer
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EXHIBIT A. SCOPE AND METHODOLOGY

We performed this audit from March through November 2006, at DOT Headquarters in Washington, D.C., and at the FAA Southern Region in Atlanta, Georgia. The audit was conducted in accordance with Generally Accepted Government Auditing Standards as prescribed by the Comptroller General of the United States and included such tests as we considered necessary to provide reasonable assurance of detecting abuse, fraud, or illegal acts.

To determine lessons learned as they relate to contract design and administration, we visited FAA's Southern Region and reviewed contract and selected task order files. We also discussed with the contracting officer the methods used for administering task orders.

In assessing the price analysis performed for the contract modification, we reviewed the contract and modification files and selected task order files for evidence of price analyses. In assessing whether task orders were fairly priced, we reviewed initial, updated, and final quotes; purchase requisitions; and associated files and support for nine orders for which FAA officials told us they had obtained revised quotes. We assessed FAA's contract administration procedures for the nine task orders.

We researched various sources of guidance, including FAA's Acquisition Management System; the United States Code; and private contracts databases and texts, such as Wifcon Forum and Cinibic and Nash's "Administration of Government Contracts." Further, we consulted with knowledgeable experts, such as professors at the Defense Acquisition University and reviewed Government Accountability Office decisions to assess administration of the contract. We reviewed FAA's revised March 2006 procedures for administering and awarding task orders, including determining when profit and administrative management rates were applied.

In reviewing the application of profit and profit rate, we reviewed a random sample of 11 task orders awarded through March 2006. We compared the effective rates awarded in the task orders with the profit limit in the Federal Acquisition Regulation and computed potential savings for the 11 orders.

We did not rely on automated databases as part of our audit. All contract actions and task orders reviewed were verified to the contract and task order files.

EXHIBIT B. COST AVOIDANCE USING 10-PERCENT PROFIT RATE

To calculate the potential cost avoidance based on a profit rate of 10 percent, we:

- Determined the actual amount of profit for each of the 11 task orders sampled (column A).
- Determined the profit for each of the 11 task orders using the 10-percent profit rate cap (column B).
- Took the difference between the actual profit amount in column A and the 10-percent profit amount in column B. This represents the potential cost avoidance had the profit rate been limited to 10 percent (column C).

Table 1. Estimated Cost Avoidance Based on 10-Percent Profit Rate

Sample	(A) Actual Profit Paid	(B) Profit if 10% Rate Applied	(C) Potential Cost Avoidance if 10% Profit Rate Applied (A-B=C)
1	$2,023,236	$1,633,669	$389,567
2	$466,730	$376,516	$90,214
3	$16,200	$13,068	$3,132
4	$149,836	$120,868	$28,968
5	$29,609	$24,082	$5,527
6	$30,090	$24,273	$5,817
7	$13,624	$11,947	$1,677
8	$13,445	$11,801	$1,644
9	$6,750	$5,445	$1,305
10	$609	$491	$118
11	$193,596	$156,168	$37,428
Total	$2,943,725	$2,378,328	**$565,397**

Source: FAA data and OIG analysis

EXHIBIT C. ESTIMATED COST AVOIDANCE FROM UPDATED QUOTES

To calculate the potential cost avoidance based on the three task orders with quotes that should have been revised, we:

- Determined the total cost of the task order using the original quotes as stated in the task orders (column A).

- Determined the total cost of the task order using the updated quotes and obtained the quotes from the task orders revised after FAA took corrective action requesting the quotes (column B).

- Took the difference between the total cost from the original quotes in column A and the total cost from the updated quotes in column B. This represents the potential cost avoidance had the contractor requested updated quotes sooner (column C).

Table 2. Estimated Cost Avoidance From Updated Quotes

Sample	(A) Original Quote: Total Costs	(B) Updated Quote: Total Costs	(C) Total Potential Cost Avoidance (A-B=C)
1	$481,440	$312,936	$168,504
2	$337,008	$252,756	$84,252
3	$295,800	$275,400	$20,400
Total	$1,114,248	$841,092	**$273,156**

Source: FAA data and OIG analysis

EXHIBIT D. MAJOR CONTRIBUTORS TO THIS REPORT

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APPENDIX. MANAGEMENT COMMENTS

Memorandum

U.S. Department of Transportation
Office of the Secretary of Transportation

Subject: **ACTION:** Comments on Office of Inspector General (OIG) Draft Report – Emergency Transportation Services Contract: Lessons Learned From the 2005 Gulf Coast Hurricanes

Date: Janury 19, 2007

From: Roger Bohnert
Acting Director, Office of Intelligence, Security, and Emergency Response

Reply to Attn. of:

To: Rebecca C. Leng
Assistant Inspector General for Financial and Information Technology Audits

Under the National Response Plan and Emergency Support Function (ESF) #1, the Department of Transportation is responsible for providing transportation support in response to domestic Incidents of National Significance. The Department's role is focused exclusively on providing transportation support for the Federal Emergency Management Agency (FEMA) and other Federal agencies. The Department's top priority at the time of an emergency is placed on providing the transportation services necessary to deliver goods, equipment, and services as quickly as possible to those in need of assistance.

The Department appreciates the OIG's recognition of the complexities involved in designing and administering the contracts for emergency transportation services. Balancing the need for expeditious and effective response to a wide range of emergencies in diverse locales within a contract structure that offers reasonable prices and protects taxpayer interests is indeed a complex endeavor. During the 2005 Hurricane season, DOT was fortunate to have in place the Landstar contract administered by the Federal Aviation Administration's Southern Region. While the contract provided a useful mechanism to expedite transportation services in response to the unprecedented devastation of that year's Gulf Coast hurricanes, post event analyses, including those by the OIG, have identified areas where improvements can be achieved. We intend to address those areas both during the ongoing recompetition for the next emergency transportation services contracts and in further administration of the present contract.

Recommendations and Response:

OIG recommends that the Office of Intelligence, Security, and Emergency Response:

Recommendation 1: Ensure that administrative fees are structured appropriately for future emergency contracts.

Response: Concur. The Department has ongoing efforts directed towards completing the next emergency transportation services contract. During this contracting effort, the Department will assess the administrative fee structures with the intention of providing a fee structure in the new contract that helps to ensure that the Federal government is paying fair and reasonable prices. The Department intends to complete the contracting effort before the end of fiscal year (FY) 2007. In the meantime, in consideration of OIG recommendations in respect to future contracts, the FAA Southern Region has secured Landstar's promise to negotiate in good faith changes to profit and administrative fee rates in the present contract.

Recommendation 2: Negotiate profit rates for future emergency contracts that are appropriate for the types of contracts awarded and in accordance with sound business practices.

Response: Concur. During the ongoing contracting process for the next emergency transportation services contract, DOT will ensure that any negotiated profit rates are appropriate for the risk inherent in the type of contract proposed and consistent with applicable regulations. The Department intends to complete the contracting effort before the end of FY 2007.

cc: Ms. Stefani, B-2
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