

## Time to Update Schedules

'Most favored customer' and price reduction policies have outlived any use.



BY ROGER D. WALDRON

After years as a contractor with the General Services Administration, Sun Microsystems Inc. canceled its Multiple Award Schedule contract, effective Oct. 12. Sun's decision came after the GSA's inspector general had raised concerns about, among other things, Sun's compliance with the MAS price reduction clause.

Congress picked up on those concerns, making a series of inquiries about the GSA's management of the contract. Eventually, both the inspector general and Sen. Charles Grassley (R-Iowa) called on the agency to cancel the contract. The agency resisted, leading to further scrutiny from the Hill. Faced with a growing controversy, Sun took the initiative and canceled its contract.

In retrospect, it had no other choice. Although cancellation does not end the investigation, Sun's ability to hold on to its contract had already been compromised. (My observations are based on current public information. During my time at the GSA, I played no role in negotiating or reviewing the Sun contract.)

This did not have to happen. Sun's difficulties should raise a critical debate over the outdated price reduction clause and the related "most favored customer" requirement. The MAS pricing policies have not fundamentally changed in 25 years. Whatever their past usefulness, the most-favored-customer pricing policy and the price reduction clause are at odds with commercial best practices today and current trends in the MAS program.

Government agencies now rely on the dynamics of the MAS commercial marketplace, effective use of electronic tools, and improved ordering procedures to ensure the best value for the taxpayer. The most-favored-customer and price reduction requirements are no longer necessary and should be eliminated.

### MAS RULES

The MAS program is the leading governmentwide marketplace for millions of commercial products and services. There

are more than 18,000 MAS contracts today, accounting for more than \$35 billion in federal purchases annually.

MAS contracts follow a two-step process. First, the GSA negotiates the basic contracts, including pricing terms and conditions. The solicitation process is always open. Second, federal agencies place individual orders with MAS contractors using streamlined competitive ordering procedures. Since the basic terms and conditions have already been negotiated, agencies and contractors can focus on competition and requirements for the specific order.

The most-favored-customer and price reduction concepts are based on a 1982 MAS policy statement. Over the years, that statement has been updated and incorporated into GSA regulations, but the basic policy thrust has not changed.

The GSA negotiates MAS contract prices based on each company's commercial pricing and discount practices. Companies are required to submit catalog and market pricing data as well as information on their commercial sales practices and categories of customers. The GSA's goal is to negotiate a price that is equal to or better than the best price afforded the company's "most favored customer" under similar terms and conditions. For example, if a company provides a 40 percent discount off the catalog price to its most favored customer, the GSA expects the same 40 percent discount.

At the same time, this most favored customer is identified as the "tracking" customer for purposes of the price reduction clause. Generally, if the company offers the tracking customer a price reduction during the life of the contract, a corresponding reduction must be provided to the government for all subsequent orders starting from the date of the commercial price reduction. Failure to pass on the price reduction results in a breach of contract and potential false-claims liability.

### COSTS OF COMPLIANCE

The GSA and its contractors spend hundreds of millions of dollars in negotiating, monitoring, complying with, audit-

ing, investigating, and, in some cases, litigating over the price reduction clause. The GSA wants a broad scope and application of the clause, while a savvy contractor wants to narrow its scope and applicability. It's a dance that costs both time and money. A prudent contractor will have an infrastructure for monitoring price reductions throughout the contract's life, while the GSA has personnel devoted to overseeing price reduction compliance.

Compliance can be daunting, if not impossible, when a company is trying to monitor a nationwide sales force aggressively competing for commercial business.

The most-favored-customer negotiations and price reduction compliance programs represent standard operating costs. If an audit of the MAS contract alleges problems, the contractor faces the additional specter of false-claims allegations, termination for cause, and suspension or debarment from federal contracting.

Yet the GSA's continued reliance on the most-favored-customer and price reduction concepts ignores major changes in what and how the government purchases under the MAS program.

Today, services account for almost 70 percent of the dollar value of purchases under the program (compared to roughly 30 percent in the early to mid-1990s). The Internet is helping companies to react in real time with price changes and new offerings. The GSA's own electronic tools provide enhanced transparency and competition at the order level for both buyers and sellers. MAS ordering procedures have incorporated robust competitive practices. Critical pricing decisions are now being made at the order level based on competition and individual requirements. In light of all this, the most-favored-customer and price reduction requirements are simply no longer relevant.

### **MORE SERVICES**

MAS contracts for information technology are a prime example of the growth in services. Last fiscal year, approximately 68 percent of the dollar value of information technology orders under the MAS was for services.

The Acquisition Advisory Panel's final report, issued July 18, is also instructive. (The panel was authorized by the Services Acquisition Reform Act of 2003 to review and recommend changes to procurement laws, regulations, and policies with a view toward better commercial practices and performance-based contracting.) The panel observed that the most-favored-customer and price reduction policies clash with the way services are priced in the commercial marketplace.

Commercial pricing for services is requirement-driven. It rests on a host of factors specific to the particular project, including complexity, technical approach, and personnel proficiency and skills. It does not lend itself to simple customer-to-customer comparisons of simple labor rates.

The Acquisition Advisory Panel specifically recommended that the GSA establish a new information technology schedule, where order prices would be based on competition to meet the particular requirements, not on

posted labor rates. Under this new schedule, the most-favored-customer and price reduction requirements would be eliminated.

### **BETTER E-TOOLS**

Other MAS changes also militate against the most-favored-customer and price reduction policies. The GSA has developed a set of electronic tools that provide transparency and enhance competition at the order level.

GSA Advantage is an electronic catalog where MAS contractors display their products and services, pricing, and other key terms and conditions. Today, there are more than 16,300 contracts, and more than 13 million commercial items, posted on GSA Advantage. Contracting officers use the site for market research and acquisition planning. Contractors use it to monitor competitive pricing. It gets tens of thousands of visitors each day.

Linked to GSA Advantage is e-Buy. Agencies use e-Buy to post their requirements and seek competitive quotes and proposals from all MAS contractors capable of meeting the agency's needs. The number of agency postings has grown each year since e-Buy was launched in 2002. In fiscal 2007, postings exceeded 50,000. GSA statistics indicate that, on average, agencies receive three quotes in response to an e-Buy posting.

### **NEW ORDERING PROCEDURES**

The Defense Department accounts for approximately 60 percent of the dollar volume of purchases under the MAS program. The National Defense Authorization Act for fiscal 2002 established a robust set of competitive ordering procedures for MAS service orders from the Defense Department exceeding \$100,000.

Defense contracting officers are required to contact and provide an opportunity to compete to all MAS contractors capable of meeting a given set of requirements. Or, alternatively, they must provide notice and an opportunity to compete to as many contractors as practicable to reasonably ensure receipt of at least three offers. If the contracting officer provides notice to less than all MAS contractors and three offers are not received, the officer may make the award only after documenting his efforts to obtain competition. The Defense Department has also extended these procedures from service orders to all MAS orders exceeding \$100,000.

Department guidance specifically references e-Buy as one medium that provides notice to all GSA schedule holders. Not surprisingly, the Pentagon is the biggest user of e-Buy, accounting for well over half the postings.

The Acquisition Advisory Panel recommended that these ordering procedures be extended governmentwide, and Congress and the Office of Management and Budget have embraced that approach. As a result, the MAS program will further emphasize competition for all orders exceeding \$100,000. The extension of these ordering procedures represents a unique opportunity to modernize MAS pricing policies as well.

The Acquisition Advisory Panel is right. The foundation of commercial practices is competition. The most-favored-customer policy and the price reduction clause are inherently noncompetitive mechanisms—they rely on audits and investigations rather than on competition. The price reduction clause, in particular, is an irrelevant trap for the unwary.

Today the MAS program relies on its electronic tools and order-level competition. The growth in services further emphasizes order-level competition and requirements development. The Acquisition Advisory Panel's recommendation

for a new competitive schedule for information technology services that eliminates the price reduction clause and most-favored-customer pricing should be expanded to encompass the entire MAS program.

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