THE UNDER SECRETARY OF DEFENSE

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ACQUISITION,
TECHNOLOGY
AND LOGISTICS

APR 12 2005

The Honorable Duncan Hunter
Chairman, House Armed Services Committee
United States House of Representatives
Washington DC 20515-6035

Dear Mr. Chairman:

Section 1073 of the Ronald W. Reagan National Defense Authorization Act Conference Report for Fiscal Year 2005 (108-767) directed Department of Defense (DoD) to "...evaluate the procurement practices of the Department of Defense in the award of service contracts for domestic freight transportation for security-sensitive cargo (such as arms, ammunitions, explosives, and classified material) to determine whether such practices are in the best interests of the Department of Defense. Enclosed is the DoD's report titled "Evaluation of Procurement Practices Relating to Transportation of Security-Sensitive Cargo" to fulfill this requirement.

My staff stands ready to discuss or brief you on the results of this evaluation. A similar letter is being sent to Senator Warner.

Sincerely,

Michael W. Wynne

Enclosure:
As stated

cc:
Honorable Ike Shelton
Ranking Member

SECRETARY OF DEFENSE

REPORT TO CONGRESSIONAL COMMITTEES

EVALUATION OF PROCUREMENT PRACTICES RELATING TO TRANSPORTATION OF SECURITY-SENSITIVE CARGO

March 2005

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EXECUTIVE SUMMARY

This report has been compiled in response to the provisions of Section 1073 of the Fiscal Year 2005 National Defense Authorization Act, which states:

"SEC. 1073. EVALUATION OF PROCUREMENT PRACTICES RELATING TO TRANSPORTATION OF SECURITY SENSITIVE CARGO

EVALUATION REQUIREMENT – The Secretary of Defense shall evaluate the procurement practices of the Department of Defense (DOD) in the award of service contracts for domestic freight transportation for security-sensitive cargo (such as arms, ammunition, explosives, and classified material) to determine whether such practices are in the best interest of the DOD.

The DOD was requested to consult with industry on this matter and to include an assessment of the following specific questions:

(1) Whether it is appropriate to consider an offer or tender from more than one motor carrier that is part of a group of motor carriers under common financial or administrative control;

(2) Whether it is appropriate to allow pricing discussions between bidders that are under common financial or administrative control; and

(3) Whether it is appropriate to treat such entities as separate companies for the purposes of awarding business on a proportionate basis.

The DOD has evaluated its methods of procuring transportation of security-sensitive cargo to determine if this serves the best interest of the government. The DOD has historically accepted such offers and made awards to each commonly owned carrier independently. There is no requirement to split traffic proportionately among carriers and, under the procurement laws, traffic awards are based upon considerations of price and overall best value to the government. DOD finds no legal basis for prohibiting price discussions between commonly owned carriers as long as they are otherwise legally permissible and not for the purpose of restricting competition. It is concluded that the current procedures are in the interests of the government and that where an offeror is found to be a truly responsible source, it is entitled to have its offers accepted regardless of common ownership.

INTRODUCTION

This Report has been compiled in response to the provisions of Section 1073 of the Fiscal Year 2005 National Defense Authorization Act, which states:

"SEC. 1073. EVALUATION OF PROCUREMENT PRACTICES RELATING TO TRANSPORTATION OF SECURITY SENSITIVE CARGO.

(a) EVALUATION REQUIREMENT. – The Secretary of Defense shall evaluate the procurement practices of the Department of Defense in the award of service contracts for domestic freight transportation for security-sensitive cargo (such as arms, ammunition, explosives, and classified material) to determine whether such practices are in the best interest of the Department of Defense.

(b) REPORT - Not later than January 1, 2005, the Secretary of Defense shall submit to the Committees on Armed Services of the House of Representatives and the Senate a report on the results of the evaluation conducted under subsection (a)."

The Department of Defense was requested to consult with industry on this matter and to include an assessment of the following specific questions:

(1) whether it is appropriate to consider an offer or tender from more than one motor carrier that is part of a group of motor carriers under common financial or administrative control;

(2) whether it is appropriate to allow pricing discussions between bidders that are under common financial or administrative controls; and

(3) whether it is appropriate to treat such entities as separate companies for the purposes of awarding business on a proportionate basis.

The question of conducting business with carriers who are under Common Financial and Administrative Control (CFAC) has been raised frequently in the past and addressed by the Military Surface Deployment and Distribution Command. In most cases the questions focused on the Personal Property (Household Goods) Program, which has various rules governing awards to household goods carriers that are commonly owned and controlled. In addition, this matter has been raised at various times in connection with the transportation of Arms, Ammunition and Explosives (AA&E).

Several factors were considered in past reviews of the policy for permitting awards to carriers in CFAC, including the requirements of the Federal Acquisition Regulation, the viewpoints of the carriers and the achievement of prompt and safe service at competitive rates. We have consistently found that permitting CFAC carriers to bid on traffic movements in competition with each other and with other carriers has promoted the full and open competition that is mandated in the procurement laws. Additionally, the interests of the DOD and the tax paying public would not be furthered by limiting awards to one carrier within a group as this would reduce needed capacity and drive up costs. It has been our experience that the policy of permitting bids from carriers in CFAC has helped meet our goal of transporting AA&E cargo at competitive rates.

1. Background

The issue of CFAC was first addressed by the Military Surface Deployment and Distribution Command (SDDC) in 1999 by Major General Mario F. Montero, Jr., in response to a Congressional inquiry. The Command's response focused on the requirements of the regulations which stipulated that carriers under CFAC must qualify each company under its own right and ensure that CFAC is declared to the Command. The issue was raised again in August of 2002 and in September of 2003 by a munitions carrier. The Command's procedures were re-evaluated and again the responses focused on the requirements of the regulations, which were found to be properly implemented.

May 2004 - SDDC was contacted by staff members of the House Armed Services Committee. These staff members informed SDDC of a proposal to amend the Armed Services Procurement Act prohibiting the DOD from considering any offer or tender from more than one company that is part of a CFAC group. This provision would have prevented DOD from considering an offer from a second carrier in any CFAC group for shipments of AA&E.

October 2004 – The final version of the Fiscal Year 2005 National Defense Authorization Act in the House Armed Services Committee had different language, which did not prohibit dealing with CFAC carriers, but instead required the Secretary of Defense to evaluate procurement practices relating to transportation of security sensitive cargo.

October 27, 2004 – Congress asked the Secretary of Defense to evaluate specific issues relating to awarding traffic to a carrier that is part of a group of carriers under CFAC; discussions between such carriers; and whether each should be given a proportionate share of the traffic.

Upon review of the historical policy, in light of current business conditions and comments received from industry, it is concluded that the DOD should continue to make awards, where otherwise appropriate, to more than one carrier in a CFAC group; should continue to allow pricing discussions between commonly owned carriers and should continue to treat such entities as separate companies when awarding shipments on a proportionate basis.

2. Carriers Under Common Financial and Administrative Control (CFAC) Policy

The governing regulations for the movement of DOD cargo are the DOD 4500-9R, Defense Transportation Regulation (DTR), and SDDC Motor Freight Traffic Rules

Publication No.1C (MFTRP NO. 1C). Neither prohibits common ownership of multiple carriers as long as SDDC is kept timely advised. Carriers owning more than one company or affiliated companies must qualify each under its own right. Thus, they must in fact be separate entities and must submit separate operating authorities, bonds, insurance, and agreements for specific modes of operation, and SCAC codes that identify the separate company group. These multiple companies must submit separate rates for each operation.

The SDDC Traffic Rules (MFTRP NO. 1C) provide that:

"Carrier understands that its initial approval and retention of approval are contingent upon establishing and maintaining to SDDC's satisfaction, sufficient resources to support its proposed scope of operations in accordance with the service requirements of the shipper. The carrier agrees to immediately notify SDDC of any changes in ownership affiliations, executive officer and/or board members, and carrier name. Carrier understands that failure to notify SDDC shall be grounds for immediate revocation of the carrier's approval for participation in the movement of DOD freight."

The SDDC contracts for transportation service under both the FAR regulation and the tender of service arrangement historically used in transportation. The FAR does not directly address the question of CFAC bidding, but in Subpart 3.3 it does discuss practices that eliminate competition or restrain trade. Such anticompetitive practices can include collusive bidding, follow-the-leader pricing, rotated low bids, and sharing of the business. However, SDDC has not found that the bidding practices of any of its AA&E carriers violate the principles set forth in the FAR.

FAR 52.203-2 contains a sample certificate of independent pricing, which is in standard use in FAR contracts. It prohibits discussions between bidders beforehand when this is done "for the purpose of restricting competition." However, the interpretation given by the Courts and the General Accounting Office on the anti-trust laws and other laws requiring free and open competition is that there is no violation when commonly owned carriers discuss their potential bids beforehand.

The tender of service from the AA&E carriers to SDDC requires them to certify that their rates have been arrived at independently without any consultation or communication with other carriers for the purpose of restricting competition. This is a standard requirement under Federal procurement regulations for entities bidding on government contracts.

The general rule is that bids submitted by affiliated companies may be accepted, unless such multiple bidding is prejudicial to the Government or to other bidders. Where a competing firm has a fair opportunity to submit a lower bid, it is not prejudiced by separate bids from two affiliates. GAO has followed this rule in the case of different bids by divisions of the same corporation (Pioneer Recovery Systems, B-214700, 84-2 CPD 520), in the case of different bids by different corporate entities under common ownership (Protimex Corporation, B204821, 82-1 CPD 247), in the case of different bids signed by the same person for two companies (51 Comp.Gen. 403), and in the case of separate, identical low bids by a husband and wife (B-186573, 76-2 CPD 60).

In these cases GAO held that the fact that two affiliated bidders may have jointly prepared and submitted two bids does not constitute collusive bidding under the Certificate of Independent Pricing where there is no evidence of an attempt by these bidders to eliminate competition from other bidders.

In a decision letter at 51 Comp. Gen. 403, GAO stated that the submission of Certificates of Independent pricing by one person for two separate firms was lawful. It said this:

"should be regarded only as indicating that the prices quoted by them were not discussed or communicated to any competitor of the two firms or to any prospective bidder other than themselves, and that no attempt had been made to induce any other person or firm to submit or not to submit an offer for the purpose of restricting competition. Thus, where separate bids have been submitted by affiliated concerns and where these bids were computed by one person or arrived at as the result of discussions between the two concerns, if such bids were submitted for apparently legitimate business reasons, it would be immaterial whether the prices which they quoted were discussed between them before submitting such separate bids."

The GAO principle that one person can submit certificates of independent pricing for two or more concerns was upheld by the Appeals Court for the District of Columbia in a case involving SDDC, The Iceland Steamship Company, LTD-Eimskip and Van Ommeran v. the United States Department of the Army, 340 U.S. App. D.C. 1; 201 F.3d 451 (January 11, 2000). The Court held that the term "competition" "does not prevent bids of separate corporate entities that have common ownership." (Pages 20, 458).

Similarly the U.S. Supreme Court in a leading decision of Copperweld Corporation, Et.Al. v. Independence Tube Corporation, 467 U.S. 752, 104 S.Ct. 2731 (June 19, 1984), held that a parent company was legally incapable of conspiring with wholly owned subsidiaries to restrain trade. And the Appeals Court for the fifth circuit held in Hood v. Tenneco Texas Life Insurance Co., 739 F.2d 1012 (August 23, 1984) that sister corporations are legally incapable of conspiring with each other to restrain trade.

The SDDC long standing policy of allowing bids from more than one bidder where there are several commonly owned companies is supported by the leading GAO and court decisions. SDDC has never made an effort to prohibit bidding by the AA&E carriers who have common ownership and any such effort would likely be successfully challenged on the grounds that it would stifle, rather than increase, competition. As noted above the accepted principle is that CFAC bidding is acceptable unless it is detrimental to the Government and over the past several years the DOD has not found it to be detrimental to the public interest.

The above decisions relate primarily to contracts entered into under the Federal Acquisition Regulation that governs government contracts. SDDC's procurement of

AA&E transportation has historically been accomplished under a tender of service arrangement, which is to a large extent conducted outside the FAR, but the general contracting principles and underlying laws that apply to FAR contracts also apply to AA&E shipments. Thus, these decisions are pertinent and controlling here.

Under the Competition in Contracting Act (41 U.S.C. 253) the DOD is required to promote full and open competition when contracting for transportation services and that is defined (41 U.S.C. 403) as being a requirement that "all responsible sources are permitted to submit sealed bids or competitive proposals" on such contracting. Thus, the DOD would face difficulties in limiting bids by CFAC carriers unless sufficient justification exists for such a policy. The DOD procurement statute at 10 U.S.C. 2304 lists examples of such justification but none are applicable here.

The question of CFAC arrangements has come up regularly in the Household Goods Program operated by SDDC and has been thoroughly examined at various times in the past. The DOD has never determined that it is in the public interest to prohibit CFAC bidding by household goods carriers; but we do require both household goods and AA&E carriers to notify the DOD of their CFAC relationships so that their operations can be overseen for any bad effects on the program. A carrier failing to disclose CFAC may be removed from the program. Household goods carriers, including freight forwarders, can exist and operate without the substantial monetary investment required of AA&E carriers and there can be an issue of household goods entities creating paper companies for the purpose of getting a greater share of the business, meaning more 'turns at the wheel', even though these paper companies bring no added capacity to the DOD. Such a situation does not readily exist in the AA&E program, as noted in the response received from a non-CFAC carrier (Tri-State, Exhibit M).

3. Summary of Industry Comments

Comments were requested from all 18 arms, ammunition and explosive carriers, the National Defense Transportation Association (NTDA) and the American Trucking Association (ATA). Responses were received from 13 carriers and the ATA. The NTDA declined to comment. Following are summaries of the comments received. The complete submissions are attached to this report.

a. R & R Trucking, Inc, AATCO, Inc., NEI Transport, LCC. R&R Trucking, which includes the separate companies of AATCO, Inc., and NEI Transport, LCC, submitted a response on November 22, 2004, which addresses the question of CFAC bidding. R&R's position is there should be no change in the present DOD policies and any change to eliminate CFAC bidders would be discriminatory; that CFAC carriers do not have any undue advantage and that they do not get a disproportionate share of shipments relative to the number of trucks offered to the DOD. R&R believes that all carriers, including those in CFAC should disclose all their affiliations that affect administrative and financial control over a carrier.

b. Landstar Carrier Group. Landstar, which includes Landstar Ranger and Landstar Inway, Inc., responded in a letter dated November 22, 2004. Landstar states a strong belief that DOD should consider proposals from every qualified carrier, regardless of its affiliation with others, so long as such affiliation is made known. Landstar observed that the exclusion of affiliated carriers would "substantially reduce" the capacity that would be available to the DOD with an increase in transportation costs and potential inability of the DOD to obtain needed service in a contingency. Landstar denies that CFAC carriers get more than their proper share of the business and states that traffic awards are based upon several factors, such as cost, past performance, and local truck availability. Their response contains statistics which show that non-CFAC carriers receive more traffic on a per truck basis than the CFAC carriers.

c. T. F. Boyle Transportation, Inc. The Boyle Transportation response of November 19, 2004, is strongly against the DOD accepting bids from more than one carrier in a CFAC group. Boyle states a belief that the reason any carrier would have more than one entity engaged in the AA&E traffic is to exploit a DOD policy of equitable distribution of traffic among bidders, and to also hedge against disqualification. The response states DOD incurs added costs by having to qualify and monitor more companies than is necessary; and that DOD cannot obtain independent pricing from CFAC companies since they surely discuss their pricing and bids with each other. Boyle quotes an SDDC policy of "When more than one carrier can provide the required Service at the same delivered cost, distribute traffic equitably." This is said to be an incentive for the industry to create more commonly owned companies in order to obtain a larger share of the DOD business, with the common owner investing no more in additional capacity than an independent carrier but receiving a disproportionate share of the business. Boyle asks that CFAC carriers be treated as one entity for the purpose of distributing traffic.

d. Chalich Trucking, Inc. Certificate of Independent Pricing should be implemented especially since there are a limited number of qualified AA&E carriers. Believes the ability of CFAC carriers to discuss their rates in-house gives them an unfair advantage.

e. Green Valley Transportation. Green Valley offered no opinion on carriers in CFAC filing rates but had several suggestions for better management of the traffic.

f. Tri-State Motor Transit Company. Tri-State is one of the larger non-CFAC carriers and states carriers operating under CFAC should be considered one entity for filing rates, which would promote more equitable distribution of DOD traffic. Tri-State notes that the substantial costs of creating additional companies "might be better spent in one corporate entity to enhance fleet efficiencies with Department of Defense being the prime beneficiary."

g. Baggett Transportation Company. The Baggett response of November 22, 2004, states a strong belief that allowing CFAC carriers to compete, each as a separate entity, with an equal share of DOD business is unfair to the non CFAC companies such as Baggett with serious financial consequences to the company.

h. FedEx Custom Critical. Multiple subsidiaries submitting rates could prove detrimental to a single entity carrier. Believes more emphasis should be placed on best value than strictly rates.

i. National Defense Transportation Association (NDTA). No position taken.

j. American Trucking Association (ATA). The American Trucking Association is a united federation of motor carriers, state trucking associations, and national trucking conferences with a membership of over 2,000 trucking companies and industry suppliers of equipment and services. ATA provided two responses, one dated November 19, 2004 and one dated November 22, 2004. ATA is opposed to any restriction being placed on trucking carriers which share common financial or administrative relationships from offering their services for DOD AA&E shipments. ATA states:

"In ATA's view, competition could not possibly be restrained by permitting all carriers, including affiliated carriers, to submit bids for the same work . . . . if the goal is to promote full and open competition, it's extremely difficult for ATA to imagine how fewer bids could be better than more bids.

k. Prestera Trucking, Inc. No reason for a carrier to have more than one entity. Carriers operating under CFAC have an unfair advantage.

EVALUATION OF SDDC PROCUREMENT PRACTICES

As noted above the practice of accepting bids or tenders (offers) from all responsible sources is sanctioned in the law. This is true even when two or more bidders are owned or controlled by the same entity. As long as rates are not agreed upon by CFAC carriers for the purpose of restricting competition, or otherwise unlawfully harming a competitor, there is no basis for objecting to the same person filing rates for two or more CFAC carriers.

SDDC sent inquiries to the eighteen approved AA&E carriers and received thirteen responses, some of which consisted of short emailed paragraphs. In general the CFAC carriers recommend that approval for CFAC be continued, and the non-CFAC carriers want it ended. SDDC also queried a large industry association, the American Trucking Association, which recommended continued approval of CFAC.

A principal objection raised by one carrier, Boyle Transportation (Exhibit J) is that allowing bids from commonly owned carriers is harmful to non-CFAC carriers such as Boyle and Tri-State, due to a claimed practice by SDDC of distributing traffic equally among the carriers. It is alleged that CFAC carriers create new companies merely for the sake of getting an extra 'turn at the wheel', thereby depriving non-CFAC carriers of their equitable share. While this may be the result in some cases, this result is not so pervasive that it should override the otherwise beneficial results of allowing the present policy to continue, nor so pervasive that it would warrant SDDC adopting a non-CFAC policy that is contrary to government wide procurement practices and regulations.

In practice traffic is not necessarily divided up equally among the carriers as there can be several factors affecting the choice of particular carriers for particular shipments. This is borne out by the statistics provided at page 2 of the Boyle letter which notes that the Landstar groups consists of four carriers and the R&R Trucking group consists of 3 carriers. If traffic were divided equally between each approved carrier the Landstar carriers could be expected to receive 4 times as much traffic as the single carriers Boyle and Tri-State, and the three R&R carriers could be expected to receive 3 times as much. However, Boyle received 12% of the DOD traffic, and Tri-State received 17%. This is much more than the average of 6% of the Landstar and R&R carriers. Indeed, Tri-State's non-CFAC percentage of 17% is almost equal to the 19% received by the combined three R&R carriers, a clear indication that CFAC carriers do not have this purported unfair advantage.

The distribution of traffic is based upon a best value selection, using such factors as quality of service, past performance, costs, claims experience, ability to perform service within stated requirements, and carrier commitment of transporation assets to readiness support.

The Boyle response states that SDDC incurs higher costs by approving and monitoring 'more companies than is necessary". However, the current cost of dealing with 18 carriers, as opposed to what would likely be 13 carriers if CFAC were not approved, is not substantial. In this respect SDDC regularly contracts with hundreds of general freight and household goods carriers.

Similar objections to CFAC were made by non-CFAC carriers Baggett (Exhibit N and Tri-State (Exhibit M). Tri-State notes that the cost of creating new CFAC companies could be better spent on enhancing the fleet of trucks of a single entity. However, Tri-State does not give an estimate of these costs and this is somewhat contrary to statements by other non-CFAC carriers that the cost of creating new companies is so minor that the CFAC carriers do this essentially to achieve another turn at the wheel.

The response from Landstar (Exhibit I) states that eliminating CFAC carriers would greatly reduce capacity and increase transportation costs. Landstar denies that CFAC carriers get a disproportionate share of traffic, stating for example that in October 2004, Boyle received 389 shipments for its 83 trucks, or 4.7 each, whereas Landstar, which had 418 trucks, received 1,080 shipments or 2.6 per truck. The response from the other CFAC entity, R&R Trucking, states it would be unfairly discriminating against AA&E carriers to eliminate CFAC for that group and retain it for the much larger group of carriers that provide general freight and household goods transportation for the DOD.

The American Trucking Association , which directly or through its affiliated organizations, represents more than 38,000 companies of every size, type and class of motor carrier operation, supports the DOD policy of allowing CFAC carriers to bid on

DOD transportation requirements, and opposes any restriction being placed on CFAC companies from offering their services to DOD.

The October 27, 2004 letter from two members of Congress (Exhibit A) expresses concern that the DOD CFAC policy with respect to AA&E might inadvertently reduce competition. The SDDC is also concerned with obtaining competitive rates and maintains continuing scrutiny of its procedures. To date there is no indication that this CFAC policy has reduced competition or resulted in higher rates. No satisfactory argument or evidence has been offered for prohibiting CFAC, which would override the general principle that bids from all responsible carriers should be considered and there is no historical evidence that allowing CFAC has been harmful in the AA&E program.

In its international household goods program SDDC does prohibit two CFAC carriers from bidding on the same lane of traffic where the bidder on a lane is guaranteed a certain percentage of the traffic for an extended period of time. This is done to prevent one carrier group from getting all or most of the traffic in that lane. Carriers in CFAC can however bid on separate international lanes, and do not have any restriction domestically. In the AA&E program such percentage guarantees do not normally exist, and AA&E motor carriers, who are subject to onerous safety and financial requirements, cannot create new companies in-house with the facility that exists in the international household goods freight forwarder industry.

CONCLUSION

The Global War on Terrorism and the sustained operations in Iraq and Afghanistan make it imperative that the DOD have the broadest access available to AA&E industry capacity. The current arrangements which permit CFAC carriers to offer the AA&E services of several of their companies has worked for a number years in terms of added capacity and enhanced competition. It would be unwise and unnecessary to now artificially drive some of that needed capacity away from DOD's needs. No compelling case for change has been made. Therefore we see no reason to risk reduced capacity and increased rates for no apparent benefit to the DOD or the taxpayer.