

December 28, 2001

KEITH STRANGE  
VICE PRESIDENT, PURCHASING AND MATERIALS

SUBJECT: Management Advisory - Review of Letter Contract with Titan Corporation  
(Report Number CQ-MA-02-001)

The Office of Inspector General is reviewing expedited contracts the Postal Service is issuing to deal with the biohazard threat facing the mail, employees, and the public. Our intent is to protect the interests of the Postal Service by making recommendations as soon as we identify issues.

We reviewed the sole source letter contract the Postal Service awarded to the Titan Corporation for over \$34 million on October 26, 2001, for eight electron beam systems. In addition, we reviewed Postal Service contracting requirements contained in the Purchasing Manual. We also conducted preliminary benchmarking with the Department of Defense and the Federal Emergency Management Agency to determine what contracting procedures they use in emergencies. We conducted our review from November through December 2001, in accordance with the President's Council on Integrity and Efficiency, Quality Standards for Inspections.

The Department of Defense indicated that in emergencies, it issues letter contracts that include what it will pay for the item being purchased and the timing of delivery. Later, when the contract is definitized, all standard contract clauses are included. Like the Department of Defense, the Federal Emergency Management Agency does not waive its standard contract clauses in emergencies. You should consider adopting similar processes for emergency Postal Service contracts in the future. Management's comments, in their entirety, are included in the appendix of this report.

While we understand the need to expedite the purchase of equipment to protect the mail, employees, and the public, we identified some contract provisions that deviated from standard contract language or were omitted from the contract. We understand that you definitized the letter contract November 8, 2001. However, to further protect the interests of the Postal Service, we recommend the following actions for future expedited contracts for irradiation equipment:

## Recommendations

1. Include the standard termination for convenience clause. A provision was included in the letter contract that required the Postal Service to pay the supplier a lump sum of \$34 million if the letter contract was not definitized by November 8, 2001, or an agreed upon extension date, or if the Postal Service terminates the contract for convenience. These terms and conditions are potentially more expensive to the Postal Service than the normal liability, which would arise under the standard Purchasing Manual termination for convenience clause.
2. Include the standard payment procedure. A payment milestone schedule was specified in the letter contract that required the Postal Service to pay the supplier 75 percent of the total cost of the equipment prior to substantial completion of equipment installation and final acceptance. Included in the 75 percent is an initial payment of 25 percent at contract award. Under standard purchasing procedures, the Postal Service is not required to make any payments until after final acceptance of commercial items.
3. Include the standard indemnification clause. A provision in the letter contract required that the supplier be indemnified and held harmless for all losses, damages, costs, and expenses except to the extent it is negligent or commits willful acts. Standard contract language in the Purchasing Manual not only holds the supplier liable for negligent or willful acts, but it also includes omissions by the supplier. The contract does not appear to hold the supplier responsible if the equipment does not meet Postal Service requirements or any other requirements mandated by law.
4. Include the pertinent penalty provisions. The letter contract omitted penalty provisions, such as liquidated damages, if the equipment does not perform as required.
5. Extend the warranty period as appropriate. The letter contract specified a one-year warranty period on the equipment. Due to the complexity and sophistication of the equipment, you should consider extending the warranty period depending on industry standards.
6. Include provisions requiring that supplier employees who provide on site maintenance and operational support possess the necessary skill levels to safely operate the equipment and handle biohazardous materials. The letter contract did not include this.
7. Consider obtaining independent verification that the supplier is giving the Postal Service its most favored prices and document the rationale for contract decisions.

### **Management's Comments**

Postal Service management agreed with our recommendations and will attempt to use standard contract clauses in future expedited contracts for irradiation equipment, with the exception of the Purchasing Manual's standard indemnification clause. Management agreed to consider including standard clauses covering termination for convenience and payment procedures in future expedited contracts. In addition, management stated its preference is to use the standard indemnification clause. However, management explained that Titan refused to agree to the inclusion of that clause in the contract, and that other irradiation equipment suppliers have raised similar objections.

Management agreed to consider including a credit remedy to compensate the Postal Service for any equipment breakdown; an extended warranty period as appropriate; and a requirement that supplier employees have the necessary skill levels to safely operate the equipment and handle biohazardous materials in future contracts. Finally, management agreed to obtain independent verification that the suppliers are providing the Postal Service their most favored prices, and to document its rationale for contract decisions.

### **Evaluation of Management's Comments**

Management's comments were responsive to our findings and recommendations. We believe the actions taken and planned address the issues identified in our report. We also believe management's response about whether to include standard indemnification clauses in future irradiation equipment contracts is reasonable because Titan and other suppliers may not otherwise contract with the Postal Service. In the future, we may review the impact, if any, of the Postal Service using non-standard indemnification clauses.

Management stated the Postal Service used approved waivers in the case of the Titan contract due to the unusual and compelling nature of the situation. Postal Service management has definitized line item 001 of the Titan contract for the purchase of the electron beam systems. Contract line items 002 and 003 for maintenance, diagnostic, and on-site operational support requirements will be definitized in the near future. Management agreed to include a requirement in those line items that Titan employees must have the necessary skill levels to safely operate the equipment and handle biohazardous materials. Also, management will include a credit remedy in the definitized contract to compensate the Postal Service for financial loss due to operational interruptions caused by any breakdowns of the irradiation equipment.

We commend management for awarding the Titan contract so quickly given the extraordinary circumstances. We believe as the immediate threat subsides, management has the opportunity to award contracts using standard contracting clauses and procedures as much as possible.

The OIG considers recommendation 3 significant and, therefore, requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action is completed. This recommendation should not be closed in the follow-up tracking system until OIG provides written confirmation that the recommendation can be closed. We appreciate the cooperation and courtesies provided your staff during the review. If you have any questions, please contact Kim H. Stroud, director, Consulting and Quick Response, at (703) 248-2100, or me at (703) 248-2300.

Robert L. Emmons  
Assistant Inspector General  
for eBusiness

cc: Richard J. Strasser, Jr.  
Susan M. Brownell  
John R. Gunnels

# APPENDIX. MANAGEMENT'S COMMENTS

HEADQUARTERS PURCHASING



December 20, 2001

ROBERT L. EMMONS

THRU: Keith Strange *KS*  
*12/20/01*

SUBJECT: Transmittal of Draft Management Advisory - Review of Letter Contract with Titan Corporation (Report Number QR-MA-02-DRAFT), dated November 9

The draft response indicating agreement or disagreement to OIG - Management Advisory Review Letter Contract with Titan Corporation (Report QR-MA-02-DRAFT), (Project Number 02BG-007CQ000), is attached.

The Automation Purchasing staff worked under severe time constraints and extraordinarily difficult circumstances in an unprecedented life and death situation facing our employees and the American public, and they performed admirably. We appreciate the discussions with the OIG's staff and their effort to provide helpful advice for future emergency acquisitions.

Phillip R. Baldwin

Attachments

OIG – Management Advisory Review Letter Contract with Titan Corporation (Report Number QR-MA-02-DRAFT) – Automation Purchasing review comments:

Introductory paragraph 2 in part states:

"The Department of Defense indicated that in emergencies, it issues letter contracts that include what it will pay for the item being purchased and the timing of delivery. Later, when the contract is defined, all standard clauses are included. Like the Department of Defense, the Federal Emergency Management Agency does not waive its standard contract clauses in emergencies.

Response: Agree with statement, unless the compelling nature of the business circumstances at the time dictates waiver of any standard clauses, if so, appropriate explanation and approval of waiver will be included in the contract file.

Our preference is to use the standard clauses in the Purchasing Manual. However, in this contract with Titan, the business situation and the circumstances of the acquisition, required some changes to the normal Purchasing procedures.

Advisory Item 1:

Include the standard termination for convenience clause. A provision was included in the letter contract that requires the Postal Service to pay the supplier a lump sum of \$34M if the letter contract is not defined by November 8, 2001, or an agreed upon extension date, or if the Postal Service terminates the contract for convenience. These terms and conditions are potentially more expensive than the normal liability that would arise under the Standard Purchasing Manual termination for convenience clause.

Response Item 1:

Agree that PM standard termination for convenience clause should be included under normal contracting procedures and that other than the standard clause should be avoided.

However, this emergency acquisition and use of the termination provision in the resulting contract arose from extraordinary conditions and circumstances, such that the use of a termination clause other than the PM standard could not have been avoided.

The situation was one in which human life had been lost due to the anthrax contamination of the mail and the potential threat of even more fatalities remained a reality. As to the circumstances in which the PM standard clause was not incorporated in the subject contract –

Through market research, Titan was determined to be the only source with available equipment to effectively combat the recent acts of biohazard terrorism. The Vice President of Engineering had urged the supplier to make available whatever quantities of this equipment it could provide. The supplier had identified 20 systems slated for other customers that it could divert to the Postal Service to meet our immediate needs. Subsequently, management decided to only purchase 8 of those systems and structure an option for the remaining 12. This action dramatically impacted Titan's financial position, as they had diverted cancelled sales from other customers to USPS.

The eight systems being acquired were approximately 80-85% complete, and ready for shipment within a period of two weeks. The supplier was unwilling to accept the standard termination for convenience clause, and was seeking their full proposed price of \$40M as the terminal liability. The Contracting Officer negotiated a lower amount, which was considered in line with the amount Titan had expended to date in the manufacture of the equipment.

As a result of the above circumstances (USPS seeking out the supplier, urging diversion of all-available equipment to USPS, USPS's change in direction - after the supplier had already cancelled sales to other customers, and the fact that the production of the equipment being acquired was already 80-85% complete) we believe that the termination clause included in the contract was just, fair, and reasonable.

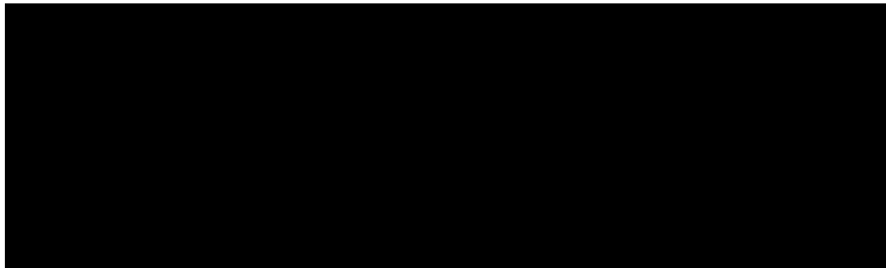
Recommendation 2:

Include the standard payment procedure. A payment milestone schedule was specified in the letter contract that required the Postal Service to pay the supplier 75 percent of the total cost of the equipment prior to substantial completion of equipment installation and final acceptance. Included in the 75 percent is an initial payment of 25 percent at contract award. Under standard purchasing procedures, the Postal Service is not required to make payments until final acceptance of commercial items.

Response 2:

Agree, that in future expedited contracts we will attempt to use the standard payment procedures contained in the Purchasing Manual.

In this emergency situation, there was an effort to embrace commercial practices consistent with the PM, especially those of irradiation suppliers in order to get to contract quickly. The payment schedule of the supplier closely followed that of its standard commercial practice. In fact, the payment upon award is less than their standard practice. Other milestones were adjusted based upon the fact that the eight systems were already 80-85% complete.



Recommendation 3:

Include the standard indemnification clause. A provision in the letter contract required that the supplier be indemnified and held harmless for all losses, damages, costs, and expenses except to the extent it is negligent or commits willful acts. Standard contract language in the Purchasing Manual not only holds the supplier liable for negligent or willful acts, but also includes omissions by the supplier. The contract does not appear to hold the supplier responsible if the equipment does not meet the Postal Service requirements or any other requirements mandated by law.

## Response 3:

Disagree, our preference is not to indemnify a contractor other than as set forth for construction contract requirements in the PM. The emergency situation in this instance is one where the Postal Service is asking the contractor to handle a product that has already caused two postal and three non-postal fatalities. In performance of the maintenance and operations support requirements of the subject contract, Titan's employees will be handling mail that may contain anthrax spores. Titan refused to provide any service without indemnification, particularly for liability actions brought by workers who may contract anthrax. Our legal counsel crafted an appropriate indemnification clause, which was negotiated into the Titan contract. Other suppliers are raising the same issue.

In addition, with respect to providing for correction of the supplier's equipment not meeting Postal Service requirements, the Titan contract does contain an appropriate remedy relying on Purchasing Manual 2.2.4a, which in part states:

"A warranty clause should be used when it is in the Postal Service's interest to reserve the right to assert claims regarding defective supplies or service after acceptance."

The contract uses the supplier's standard commercial warranty.

## Recommendation 4:

Include the pertinent penalty provisions. The letter contract omitted penalty provisions such as liquidated damages, if the equipment does not perform as required.

## Response 4:

Agree that a remedy should be considered in future expedited contracts to compensate the Postal Service, in the event the equipment does not perform as required. We will include in the Titan contract a process whereby the Postal Service is given a credit to compensate for financial loss due to equipment breakdown. We will attempt to include the same or a similar remedy in future expedited contracts. We do not believe the Titan contract should have included liquidated damages, especially in light of PM 2.2.6.b in that liquidated damages may not be used as a "penalty" for failure to deliver on time or perform. Liquidated damages also adds supplier risk, which typically results in increased costs.

We are confident that the e-beam technology at the dosage being applied will perform as required and be successful in destroying anthrax. This belief is substantiated by a July 30, 2001 study by the Army, Titan, and others entitled: "Efficacy of Electron Beam To Decontaminate Chemical, Biological, Warfare Agents, Phase 1." The testing of the study was for the Armed Forces Radiological, Biological Research Institute. The study results affirmatively showed that the target dosage of the JSPS's contract with Titan does kill anthrax.

There are remedies in the subject contract that do protect the Postal Service if the equipment does not perform as required (e.g., warranty provisions and termination for default clause).

## Recommendation 5:

Extend the warranty period as appropriate. The letter contract specified a one-year warranty period on the equipment. Due to the complexity and sophistication of the equipment, you should consider extending the warranty period depending on industry standards.



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Response Item 5:

We will consider the need for a longer warranty period in future requirements.

It should be noted that based upon proposals from Titan and IBA, dominant suppliers of e-beam and/or x-ray irradiation equipment, that one-year appears to be their industry standard warranty period.

Advisory Item 6:

Include provisions requiring that supplier employees who provide on-site maintenance and operational support possess the necessary skill levels to safely operate the equipment and bio-hazardous materials. The letter contract did not include this.

Response Item 6:

Agree. We intend that the Requirements Document that will form part of the contract will include a requirement that the supplier provide such evidence for its employees.

Advisory Item 7:

Consider obtaining independent verification that the supplier is giving the Postal Service its most favored prices and document the rationale for contract decisions.

Response Item 7:

Agree. However, on the instant purchase, we believe that the analysis of orders of the same or similar equipment from other customers of the supplier has shown that the Postal Service paid no more or slightly less than other buyers. Additionally, proposed prices in a proposal from IBA for the same or similar equipment are higher than the price paid under the subject contract.

We appreciate the discussions with the OIG's staff and the effort to provide helpful advice.