

## VALUE ENGINEERING CHANGE PROPOSALS (VECP)

### CAPTURE AN INCREASED SHARE OF THE COST SAVINGS

#### INTRODUCTION

Value Engineering Change Proposals (VECPs) incentivize prime construction contractors to voluntarily submit proposals to identify ways the Federal Government can reduce costs. In turn, if the government accepts the proposal, a contractor is entitled to **share in the savings on the contract** with no reduction in profit (and possibly an **increase in profit margin**). While the government is not obligated to accept the proposal, VECPs allow a contractor a means of suggesting a cost-saving mechanism to the current or instant contract. In an era where it seems like government is constantly under the gun to do more with less, VECPs provide contractors with a tool to benefit from these practices and increase their profits. This article discusses what a VECP consists of, when it is authorized, a summary of how to prepare it, and a real world example of a VECP.

#### WHAT IS A VECP?

Under the Federal Acquisition Regulation (FAR), a VECP is a proposal that **“requires a change to the instant contract that results in reducing the contract price or estimated costs”** without impairing essential functions or characteristics, but does not involve a change in the deliverable end item quantities or the contract type. FAR 52.248-3. The prevailing literature on VECPs opines that in order for the proposal to be valid, the contractor must be legally obligated to perform the work outlined for a proposed change, must specifically identify its proposal as a value engineering change, and set forth the specifics of the change.

Thus, the **basic concept** behind a VECP is that if the prime contractor suggests an idea to the Federal Government that would result in an overall cost savings on the current contract (which is accepted), then that contractor can share in that net savings and as a result, increase their profit margin. The **ONLY** caveat therein would be that the Government has no obligation to accept the proposal, and if it is denied, that decision is non-appealable under the Disputes clause of the contract or the Contract Disputes Act of 1978. Any challenge by the contractor would require an action in Federal court based on a violation of the Administrative Procedures Act. However, in the event that the Government were to subsequently implement a change that mirrored the one previously rejected, it is likely that the reviewing authority would find that the contractor is entitled to compensation.

In the Federal contracting arena, the **VECP clause is mandatory** for all fixed-price construction contracts over \$100,000, unless the head of an agency has elected to exempt their agency or a particular contract from the value engineering requirements. FAR 48.201(a) additionally requires that a value engineering clause be included in all contracts for supplies and services, except for the those involving: (1) Research and development (other than full scale development); (2) Engineering services from non-profit organizations; (3) Personal services (one creates an employee-employer relationship with the government); (4) Product /component improvement already on contract; (5) Commercial products not involving packaging specifications or other special requirements; and (6) Contracts which an agency head exempts. Moreover, a value-engineering clause, found under FAR 52.248-1, can be included in contracts of a lesser value when its use is deemed appropriate.

Value engineering is also outlined under FAR 48.202 Assignment of Contract Administration, which requires the contracting officer to insert a VECP clause when the contract amount is estimated to exceed the simplified acquisition threshold, unless

an incentive contract is contemplated. Despite this, the contracting officer may include the clause in contracts of lesser value if that officer sees a potential for significant savings. But, the contracting officer shall not include a VECP in an incentive-type construction contract.

While again the VECP can result in a share of the net savings, some contracts determine the share on the financial risk of the agency involved. Most contracts provide for a set percentage of the net savings, (usually **55 percent**), **plus whatever reasonable development and implementation costs are expended**. Importantly, the contractor may often receive some or the entire portion of the costs they expend in order to develop a proposal.

The contractor's share of VECP savings include not only those savings derived from the instant contract, but also those savings on **concurrent** and **future contracts** to which the VECP is applied. Note: savings on future contracts are shared during the "sharing period," which is from 36 to 60 months after acceptance of the first VECP, determined at the discretion of the Contracting officer.

## HOW TO PREPARE A VECP

In preparing a VECP, a contractor must follow the provisions of FAR 52.248-3(c), which require:

- (1) A description of the **DIFFERENCE** between the existing contract requirement and that proposed by the change, the **comparative advantages** and disadvantages of each, a **justification** when the item's function or characteristics are being altered, and the effect of the change on the end item's performance;
- (2) A list and analysis of the contract requirements that must be changed if the VECP is accepted, including any suggested specification revisions;
- (3) A separate and detailed cost estimate for: (i) the affected portions of the existing contract requirement, and (ii) the VECP. (the cost reduction associated with the VECP shall take into account a contractor's allowable development and implementation costs, including any amount attributable to subcontracts);
- (4) A description and **estimate of costs the Government may incur** implementing the VECP, such as costs related to tests, evaluations, operations, and support;
- (5) A prediction of any effects the proposed change would have on **collateral costs** to the Government agency;
- (6) A statement of the time by which a contract modification accepting the VECP must be issued in order to achieve maximum cost reduction, noting any effect on the contract completion time or delivery schedule;
- (7) Identification of any **previous submissions of the VECP**, including the dates submitted, the agencies and contract numbers involved, and previous Governmental actions on the same, if known.

In addition, FAR section 52.248-3 provides that if the proposed change is affected by configuration management or similar procedures required by the instant contract, then the instructions outlined in those procedures relating to format, identification, and priority assignment will govern VECP preparation.

## VECP IN ACTION – A REAL WORLD EXAMPLE

An illustrative example of how a VECP functions on a real project is found in the *Appeal of King Construction Company*, ASBCA No. 38303, (1993). In *King*, the contractor prepared a bid on a runway project, and **raised its concerns** about the soil subgrades and the plasticity of the subgrades at time of bid. Borings were taken by the contractor because the Government had not taken borings since the original runway work was performed some 20 years prior. The borings showed that the secondary subgrade had a high plasticity, making the Government design specification defective. The contractor feared that if the Government's design were followed, "pumping" would occur in the unstable subgrade during construction. The contractor proposed the use of a different method to avoid the "pumping" effort which would result in a decrease of performance costs.

The contractor originally submitted a request for variance for the pumping problem. The Government treated the pumping problem as a differing site condition and issued a deductive change order. The contractor then resubmitted its request as a VECP. Notwithstanding the resubmission, the Government deducted costs for the contractor's proposed method. As a result of the deductive change order, the contractor was not permitted to share in the savings achieved by use of the contractor's proposed method (i.e. only the Government would benefit from the cost savings achieved by the proposed method).

The contractor's VECP represented a **novel engineering alternative**, which became reality only after the contractor enterprisingly availed itself of (1) the latest scientific testing techniques and (2) explored the existing bored soil conditions and consulted with a recognized runway expert. The contractor's investment in research and development produced a better, simpler and cheaper design to accomplish the contract's objective.

When this case was appealed to the ASBCA, the Board found that the Government's interpretation of what met the definition of VECP was unreasonable. What the VECP accomplished was not a simple reduction in deliverable end item quantities. Rather, the VECP eliminated, to a large extent, the need for lime stabilization in the subgrade by proper utilization of existing site conditions. The contractor was found entitled to 55% of the savings realized by the unilateral deductive change order. Had the contractor not pursued the VECP, it would have been penalized by the Government deducting costs, which would have reduced the contract price.

## CONCLUSION

While the requirements outlined above may involve meticulous preparation, review, and attention, the dividends that can flow from the use of VECP can be well worth the time invested.

The shared cost savings that can be realized may also pay off in the form of continued and future business, overall product and process improvement, improved relations with Government personnel, and benefits yet realized from past experiences.

In order to maximize your standing and potential for success in preparing your VECP, consider enlisting the outside guidance and counsel of a consultant, who can help identify methods to increase and exceed your profit goals.

Remember that consultant costs may be part of the upfront development costs, making these costs recoverable in most instances.

**In the end, you will be glad you made the call; by the way, it's a FREE CALL.**

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