

VALUE ENGINEERING CHANGE PROPOSALS (VECP)

CAPTURE A 55% SHARE OF THE COST SAVINGS FOR AN EXTENDED SHARE PERIOD ON LONG-TERM CONTRACTS

INTRODUCTION

Value Engineering Change Proposals (VECPs) incentivize government contractors to voluntarily submit proposals to identify ways the Federal Government can reduce costs on the contract. 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 the contractor a means of suggesting a cost-saving mechanism to the current contract. In an era where it seems like government is constantly under the gun to do more with less, VECPs provide contractors a tool to benefit from these practices and increase their profits. This article discusses what a VECP consists of (including a potentially extended share period of cost savings), when it is authorized, a summary of how to prepare it, and a real-world example of a VECP.

WHAT IS A VALUE ENGINEERING CHANGE PROPOSAL?

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 *must* 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 will 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 rejected, that decision is non-appealable under the Disputes clause of the contract or the Contract Disputes Act of 1978.]* Any such 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 court or board of appeals 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.

Again, while the VECP can result in a share of the net savings, some contracts determine the share on the financial risk of the agency involved. The FAR clause provides for a set percentage of the net savings, (usually **55 percent**) go to the contractor, **plus whatever reasonable development and implementation costs are expended**. Importantly, the contractor may often **receive part or the entire portion of the costs they expend up front** to develop a proposal.

A very important development in the VECP rules should be noted: 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, **or, the last scheduled delivery date** of an item affected by the VECP, whichever is later. (FAR 48.104-1.) Thus, the potential for an extended sharing period can be greatly beneficial and lucrative on long-term, multi-year contracts. On certain contracts, the latter sharing period could result in a significant increase to your bottom line!

HOW TO PREPARE A VECP

As with any proposal submitted to the government, the primary goal is to persuasively show the Contracting Officer how the cost savings will be achieved and why accepting the proposal will be in the government's best interest.

In preparing a VECP, a contractor **must** follow the provisions of FAR 52.248-3(c) for the proposal to be considered a VECP and allowing the contractor to share in the cost savings to the government. The proposal must demonstrate how "instant cost savings" and "future cost savings" will be produced for the government. Otherwise, a submitted proposal may be deemed a Request for Deviation (RFD) for which a deductive modification may be issued, causing a reduction in the contract (and profit) amount without the contractor being entitled to a percentage of the savings. Thus, a VECP must contain the following:

- (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.

If a contractor wants to share in the cost savings that can result from his suggestions, **it is imperative that the contractor specifically identify** their suggestion as a “VECP” and prepare and submit his suggestion in the form and manner provided in its contract. Strict compliance with the requirements of FAR 52.248-3 and other applicable terms of your specific contract is required.

Indeed, many decisions of the court and boards of appeal involve situations where a contractor alleges that the modification deleting work was in response to a VECP. However, the courts and boards have disposed of a number of these cases by finding that the contractor **did not follow the procedures** in the contract’s VE clause and therefore was not entitled to a share in the cost savings. *Xerox Corporation*, ASBCA 16374, 73-1 BCA ¶ 9784.

VECP IS WIDELY APPLICABLE

Most VECPs involve the substitution of “less costly items” for the ones specified or the use of “methods that differ” from the specified methods.

However, value engineering proposals have been accepted covering a wide range of changes, including the correction of errors in the specifications and the elimination of references to some sources. The courts have even found that a contractor’s proposal providing access to the work site earlier than the contract provided constituted a valid VECP. *Vemo Company*, ASBCA 31911, 88-3 BCA 20977, (1988). In another case, the ASBCA awarded additional compensation to a contractor whose VECP was the reduction in the number of the explosion-proof motors needed to operate roll-up doors on a fuel systems maintenance facility at Eglin Air Force Base. *W. R. Johnson, Inc.*, ASBCA 40251, 91-3 BCA 24172, (1991).

Additionally, the pertinent regulations and case law do not preclude a pure deletion of work as constituting a valid and acceptable VECP in which a contractor should share in the savings to the government. Based on the applicable regulations, if a contractor were to propose, as a VECP, that the government delete a portion of its work, and the deletion did not impair the essential functions of the project, then, if the government proceeds to change the contract accordingly, the contractor would be entitled to an equitable adjustment of its contract price to reimburse it for a share in the cost savings associated with deletion of the work.

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), which matter was prepared by Excell, then raised and successfully argued by Excell and its then-general counsel.

In *King*, the contractor prepared a bid on a runway project and **raised 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 had largely **eliminated** 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. Excell stands ready to assist in your pursuit and successes.

If you believe you may have a situation appropriate for a VECP, give Excell a call today to discuss your situation.

Consultation calls with Excell are always FREE, and Excell can and will help to maximize your recovery! Flights have never been cheaper and Excell is standing by to assist, no matter the location.

CALL TODAY! (719) 599-8336!

**EXCELL CONSULTING:
"HERE TODAY FOR YOUR TOMORROW."**

Author's note: The information contained in this article is for general informational purposes only. This information does not constitute legal advice, is not intended to constitute legal advice, nor should it be relied upon as legal advice for your specific factual pattern or situation. – Taylor Benson, Esq., Asst General Counsel & John Balch, CEO