

REPORT BY THE  
AUDITOR GENERAL  
OF CALIFORNIA

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**THE DEPARTMENT OF HEALTH SERVICES  
NEEDS BETTER CONTROL OF  
HAZARDOUS WASTE CONTRACTS**

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REPORT BY THE  
OFFICE OF THE AUDITOR GENERAL

P-582.1

THE DEPARTMENT OF HEALTH SERVICES NEEDS BETTER  
CONTROL OF HAZARDOUS WASTE CONTRACTS

MARCH 1986



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Auditor General

March 13, 1986

P-582.1

Honorable Art Agnos, Chairman  
Members, Joint Legislative  
Audit Committee  
State Capitol, Room 3151  
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the Department of Health Services' activities to procure and administer hazardous waste contracts. The report states that the department is not contracting for toxics-related services in accordance with all state and federal requirements and that it is not properly managing those contracts. We make recommendations to improve the deficiencies noted in the report.

Respectfully submitted,

  
THOMAS W. HAYES  
Auditor General

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## SUMMARY

The State has paid for questionable costs, has made excessive payments, and has jeopardized federal funding because the Department of Health Services (department) has not adequately procured and managed the State's contracts for toxics-related services.

In contracting for toxics-related services, the department has failed to follow state and federal requirements by authorizing contractors to begin work without a contract, by not using competitive bidding techniques or negotiating reasonable prices, and by inappropriately using its emergency contract exemption provision. Furthermore, the department's contracts do not clearly define all allowable charges and do not protect the interests of the State because the contracts contain vague provisions and fail to contain all standard contract language. These contracting deficiencies resulted because the department allowed engineers and other staff within the Toxic Substances Control Division to procure contracts for toxics-related services even though they were not experienced contract administrators and did not have sufficient knowledge to adhere to state and federal contracting requirements. As a result, the State has incurred unnecessary and unreasonable costs and has jeopardized the receipt of federal funds.

Furthermore, the department has poorly managed the State's contracts for the cleanup of hazardous waste sites. For example, the department paid for inappropriate costs, made payments twice for the same personal services and equipment, and allowed contracts to continue after it was not economical to do so. Because the department did not regularly monitor the work of its contractors, eliminate duplicate payments, or verify that contractors performed the work they were required to do, the State has incurred at least \$1.4 million in questionable or unreasonable costs. Additionally, although the department terminated its contracts for the McColl Hazardous Waste

Disposal Site in November 1985, the State incurred approximately \$1 million in unnecessary costs from June 1985 through October 1985 because the department did not terminate the contracts sooner. Finally, the department does not always pay for labor, equipment, or material at the rates included in the contract, it does not always account for and track charges for different contract items, and it sometimes delays payments to contractors. Consequently, the department has paid contractors more than it should have, and it has jeopardized the progress of work at one hazardous waste site. After we brought these problems to the attention of department officials, the department halted a \$557,982 payment to one of its contractors.

Despite its recent efforts to improve its contract procurement process, the department is still experiencing problems not only in procuring but also in managing its hazardous waste contracts. This report makes a number of recommendations addressing these problems. For example, to improve its procurement of these contracts, the department should, among other things, continue to use the Office of Procurement and Contracts, and it should ensure that this office is run by an experienced and fully qualified contract administrator. The department should also ensure that its own contracting staff are fully trained in contract administration and that they adhere to state and federal contracting requirements.

In addition, to improve its management of hazardous waste contracts, the department should be sure that a properly trained representative of the State is on site to monitor the work at a hazardous waste site when that work is being performed for the State. Additionally, the department should immediately undertake termination or closeout audits of the major contractors at the McColl Hazardous Waste Disposal Site to identify and collect all payments made in excess of contract specifications and to recover all duplicate payments and payments for work that was not performed.

## INTRODUCTION

The objective of California's hazardous waste management program is to protect the public health and the environment from the harmful effects of hazardous waste. This program regulates the various activities involving hazardous waste: generation, storage, treatment, and disposal. In addition, the program includes evaluating hazardous waste sites, coordinating emergency response actions, and administering resource recovery and health and safety programs.

### Legislation

In 1972, the Legislature passed the hazardous waste control law to ensure the safe generation, storage, treatment, and disposal of hazardous waste, and it designated the Department of Health Services (department) to administer the law. In 1976, the federal government instituted a nationwide program for managing hazardous waste by enacting the Resource Conservation and Recovery Act of 1976. This act required the federal Environmental Protection Agency (EPA) to develop comprehensive standards for controlling hazardous waste and to implement a national hazardous waste management program. This act allows a state to operate its own hazardous waste management program if the EPA considers the state program to be substantially equivalent to the federal program.

In 1980, the federal government enacted the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 to provide, among other things, funds for use by state and federal governments in responding to problems at hazardous waste sites. This legislation enabled states to enter into cooperative agreements with the EPA so that states could respond to hazardous waste problems.

#### Program Administration

In 1981, the department created the Toxic Substances Control Division to continue the implementation and enforcement of California's hazardous waste management program. The Toxic Substances Control Division, which has its headquarters in Sacramento, has three regional offices throughout the State and conducts its field inspection and enforcement activities from these regional offices.

In addition to other responsibilities, the Toxic Substances Control Division awards and administers contracts for the identification, cleanup, transportation, and disposal of hazardous waste throughout California. Since 1982, the Toxic Substances Control Division has awarded over 160 contracts totaling more than \$80 million. These contracts have ranged from permitting state-funded emergency responses by private companies to hazardous wastes discoveries throughout the State to hiring a public contractor to determine the toxicity of wastes.

In 1985, the EPA's Office of the Inspector General reviewed the department's administration of its cooperative agreement with the EPA. The objectives of the EPA's review were to determine the effectiveness of the department's administrative controls, to ascertain the State's compliance with federal agreements and regulations, and to determine the reasonableness of the costs claimed under this agreement. The EPA concluded that the department had not always established the procurement and accounting procedures necessary to administer its contracts.

Previous Auditor General Reports  
On California's Hazardous  
Waste Management Program

Since October 1981, the Auditor General has issued six reports on the State's hazardous waste management program. In October 1981, the Auditor General reported on the department's efforts to issue permits to hazardous waste sites, to enforce hazardous waste control laws, and to control the transportation of hazardous waste. The report concluded that, as a result of weaknesses identified in each of the areas, neither the public nor the environment was sufficiently protected from the harmful effects of hazardous waste. (Report P-053: "California's Hazardous Waste Management Program Does Not Fully Protect the Public From the Harmful Effects of Hazardous Waste.")

In October 1983, in response to questions from the Legislature regarding the cleanup of the Stringfellow Toxic Waste Disposal Site,

the Auditor General reported on the letting of contracts and on contractor compliance with contracts at this hazardous waste site. In addition, the Auditor General reported on the effectiveness of the interim cleanup of the site. The report included recommendations for the future selection of contractors and discusses the possibility of federal reimbursement for the costs of the cleanup. (Report P-244: "Review of Selected Contracts for Cleanup of the Stringfellow Toxic Waste Disposal Site.") A June 1984 follow-up to this report presents an additional review of a contract award at the Stringfellow Toxic Waste Disposal Site.\*

In November 1983, the Auditor General issued a follow-up to the 1981 report on the State's hazardous waste management program. This report concluded that the department had issued few permits to facilities that handle hazardous waste, had not effectively enforced hazardous waste laws, and had not effectively monitored the transportation of hazardous waste. (Report P-343: "The State's Hazardous Waste Management Program: Some Improvement But More Needs To Be Done.") A January 1984 report provides additional information on the department's contracting process.\*

Finally, in August 1985, the Auditor General reported on the department's involvement in the cleanup of 125 hazardous waste sites in California. This report concluded that the department required,

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\*Appendix B discusses the department's efforts to implement the recommendations on contracting contained in this report.

reviewed, and monitored the progress of cleanups at the majority of these sites. However, the report stated that the department did not accurately report the quantities of hazardous waste cleaned up at 55 of the 125 sites. The report also noted that the department did not have uniform procedures for documenting the cleanup of hazardous waste sites. (Report P-565: "The Department of Health Services' Involvement in the Cleanup of Hazardous Waste Sites.")

#### SCOPE AND METHODOLOGY

The purpose of this audit was to examine the Department of Health Services' procurement and management of hazardous waste contracts with private and public contractors between January 1, 1983, and November 15, 1985.

To determine the department's role in procuring hazardous waste contracts, we reviewed an audit report by the Environmental Protection Agency of state and federal hazardous waste contracts. We reviewed the scope of the work performed in this audit and determined whether we could rely on its conclusions in order to limit the number of contracts we needed to review. We then reviewed state and federal contract procurement criteria, and we used the criteria to measure the State's compliance during its procurement of contracts that were not included in the EPA's audit.

To determine the department's role in administering hazardous waste contracts, we reviewed the methods that the department used to approve and pay invoices for work at hazardous waste sites. We examined the department's method for ensuring that tasks contracted for and the labor, equipment, and material used to perform these tasks were performed or used by the contractor in compliance with the terms of the contracts.

To determine the accuracy of the department's payments to contractors and to determine whether the contractors performed work and charged rates for this work in compliance with their contracts, we reviewed invoices and supporting documentation sent to the State by contractors performing toxics-related work for the State. We then reviewed the records of these contractors to determine whether they had actually performed the work and whether they had actually used the labor, equipment, and material paid for by the State to perform this work. We also reviewed the records of both the contractors and the department to determine the time that the contractor waited before receiving payment from the State for the work performed. We then attempted to determine why any inaccurate payments, delays, or noncompliance with the contract occurred.

Finally, to determine whether the department implemented recommendations from previous Auditor General reports that addressed contracting, we reviewed the recommendations and the department's responses to them. We then interviewed department personnel and

reviewed department records to determine the extent to which the department had implemented these recommendations.

We discussed the contents of this report with the private and public contractors referred to, and we considered their comments in preparing the final version of this report.

## AUDIT RESULTS

### I

#### THE DEPARTMENT OF HEALTH SERVICES IS NOT CONTRACTING IN ACCORDANCE WITH STATE AND FEDERAL REQUIREMENTS

The Department of Health Services (department) is not contracting for toxics-related services in accordance with all state and federal requirements and is not complying with all of the provisions of its agreements with the Environmental Protection Agency (EPA). The department authorized some contractors to work before a valid contract was in effect, did not utilize competitive bidding techniques or negotiate reasonable prices, and inappropriately used its emergency contract exemption provision. Also, the department is preparing contracts without necessary contract language and with vague contract terms; consequently, the contracts do not clearly define all allowable charges and do not protect the interests of the State.

These procurement deficiencies resulted because the department allowed engineers and other staff within the Toxics Substances Control Division to contract for toxics-related services even though they were not experienced contract administrators and did not have sufficient knowledge to adhere to state and federal contracting requirements. As a result, the State has incurred unnecessary and unreasonable costs and has jeopardized the receipt of federal funds. Despite recent efforts to improve its award of contracts, the department is still experiencing problems in procuring hazardous waste contracts.

The Department Is Authorizing  
Work Without A Valid Contract

The department has not always had valid contracts in effect by the beginning date of the contract, and it has allowed some contractors to begin work without a valid contract. This practice exposes the State and the contractor to potential liability involving disputes between the department and the contractor. Additionally, this practice does not conserve the rights and interests of the State, and it unnecessarily exposes the State to the risk of litigation.

Public Contract Code Section 10295 states that a contract is not valid until approved by the Department of General Services or signed by the contracting department if the contract is exempt from approval by the Department of General Services.

Of the ten contracts we reviewed for compliance with procurement requirements, we found that the department signed all ten after the beginning date specified in the contract, and in four of these ten contracts, contractors began work before the department signed the contracts. For example, on May 24, 1985, the department signed a contract with the IT Corporation to haul hazardous waste from the Stringfellow Toxic Waste Disposal Site even though the beginning date specified in the contract was February 15, 1985. The department thus allowed the contractor to begin work without a valid contract. The IT Corporation performed \$762,000 worth of hauling services before the department awarded the contract to perform this work. It appears

in this instance that the department verbally authorized the contractor to begin the work in February. The department had adequate knowledge and sufficient time to execute this contract before the IT Corporation began the hauling called for by the contract.

The Department Is Not Complying With  
Competitive Bidding, Price Negotiation,  
And Emergency Exemption Requirements

The department does not always competitively bid contracts that should be competitively bid, appropriately negotiate the price for a contractor's services when a contract is not competitively bid, and appropriately use its exemption from state contracting requirements. The department should have but did not competitively bid two of the ten contracts we reviewed. Moreover, the department did not negotiate the price of six sole-source contracts to obtain the best price available. Finally, the department used its emergency exemption in awarding two contracts even though both contracts had been competitively bid and had gone through the department's lengthy evaluation process.

State Administrative Manual Section 1204 and Public Contract Code Section 10348 require competitive bidding except in those rare instances when the Department of General Services agrees that only one contractor can provide the skills or knowledge that no other contractor can provide. Two of the six sole-source contracts we reviewed should have been competitively bid but were not. Both of these contracts were with the Radian Corporation for phase II cleanup work at the McColl

Hazardous Waste Disposal Site. The department justified using the Radian Corporation because it had been the contractor on the first phase of the cleanup project. However, we believe the department's justification does not correspond to state contracting requirements because the Radian Corporation was not uniquely qualified and was not the only contractor that could provide the general engineering and management services called for in the contract. Furthermore, in an audit report released in August 1985, the EPA's Inspector General stated that the original procurement of the contract for phase I had limited competition, was therefore flawed, and was not a sufficient justification on which to base future sole-source contracts. The total cost of the phase II contracts is \$695,462 and may be entirely the State's financial responsibility if the federal government decides not to pay its 90 percent share of the costs incurred on these contracts.

The Code of Federal Regulations (40CFR33.520) requires states to conduct meaningful negotiations to obtain the best prices for sole-source contracts. However, the department did not negotiate the price of the six sole-source contracts we reviewed; four of these contracts involved a total of \$5 million in federal Superfund monies. In one case, for example, the Radian Corporation's project manager for the McColl Hazardous Waste Disposal Site said that the Radian Corporation submitted a proposed cost schedule and budget, both of which the department approved. To reduce costs, the department asked the Radian Corporation to submit a revised budget based on a reduced level of effort and scope of work. However, the department did not

negotiate the price for any of the labor or services except for an overhead rate for field services; negotiations took place only on the work and resources to be included in the reduced scope of work. The Radian Corporation was prepared to negotiate cost, but the department approved the cost schedule and budget without any of the customary price negotiations. Because the department did not negotiate the price of the contract, the State has no assurance that it has obtained the best price available. In addition, the federal government may choose not to pay its share of costs if it does not believe they are reasonable.

Finally, Health and Safety Code Section 25358.5 exempts the department from the State Contract Act when the director of the department determines that there may be an "imminent and substantial endangerment" to the public health or welfare or to the environment because of a release or threatened release of a hazardous substance. This provision permits the department to more quickly process its contracts by circumventing the normal state procurement procedures, including a legal review by the Department of General Services. The department used this provision to award two contracts totaling over \$1 million to the IT Corporation so that it would be available to respond to toxics-related incidents should they occur. However, the department's use of the "imminent and substantial endangerment" exemption was inappropriate. Both of these contracts were advertised in the State Contracts Register, were competitively bid, and went through the entire evaluation processes at the department. These

processes took six and ten months, respectively. If there had been a need to expedite the procurement of these contracts, the department would not have started the competitive bidding process. Therefore, after having gone through the bidding and evaluation processes, the department had no need to invoke the "imminent and substantial endangerment" exemption. As a result, the department may be preparing and approving contracts that do not fully protect the interests of the State. The EPA's Inspector General has also taken issue with the department's use of the "imminent and substantial endangerment" exemption in procuring for hazardous waste contracts.

The Department Is Preparing Contracts  
Without Necessary Contract Language  
And With Vague Contract Provisions

The department is awarding contracts that do not fully comply with standard language requirements of either the State or the federal government. These language requirements protect the State from costs or liabilities that cannot be foreseen at the beginning of the contract. None of the ten contracts we reviewed fully complied with standard language requirements. Additionally, because of vague contract provisions, the department has had difficulty in resolving disputes with its contractors over the scope of work and costs.

The Code of Federal Regulations, the State's Public Contract Code, and the State Administrative Manual specify the standard clauses that must be included in contracts involving federal or state funds.

Three of the seven contracts we reviewed that the department awarded under its cooperative agreements with the EPA lacked some of the mandatory contract clauses pertaining to model subagreements, labor standards, and federal cost principles. The federal government could refuse to pay its share of costs for those contracts that it does not believe are appropriately prepared. Furthermore, all seven of the contracts that the department awarded under its cooperative agreements with the EPA lacked from one to 11 of the 13 major clauses that we tested and that were required by state regulations. These clauses pertained to equipment purchases, evaluation of contractors' performance, resolution of disputes, contract retentions, and purchase approvals. Finally, two of the three miscellaneous contracts we reviewed lacked state-required contract clauses related to contractor evaluation, resolving disputes, and contractors' recordkeeping.

Additionally, because of vague contract provisions, the department has had difficulty resolving disputes with its contractors concerning the scope of work and the costs that are allowable under its contracts. For example, one of the department's contracts with the Radian Corporation did not fully describe those costs that were allowable for travel, per diem, and moving expenses. The department challenged these costs but is concerned that the contract language will not permit denying the costs. Should the department's challenge fail, the State may be required to pay more in travel, per diem, and moving costs than it originally intended to under this contract.

## Reasons For The Deficiencies In The Department's Contracting

While there may have been circumstances requiring the department to authorize a contractor to begin work without a valid contract or to award a contract without negotiating prices, most of the deficiencies that we found in the department's contracting did not result from a need to respond immediately to an emergency. Rather, these deficiencies resulted because the department allowed the engineers and other staff within the Toxics Substances Control Division to contract for toxics-related services even though they were not experienced in contract administration and did not have sufficient knowledge to adhere to state contracting requirements such as writing requests for proposals and bidding and awarding contracts. Consequently, the State may have incurred unnecessary and unreasonable costs and may have jeopardized federal funding for hazardous waste contracts. Additionally, in December 1985, the EPA criticized the State for many of the same procurement deficiencies we identified during our audit.

## Action Taken By The Department In Its Recent Contracting

In response to earlier criticisms of its procedures for procuring and awarding contracts for the cleanup of hazardous waste sites, the department changed its methodology for procuring these types of contracts. In late 1984, for example, the department created a new

office to procure contracts and began using the Toxic Substances Control Division only for advice on the request for proposal dealing with the technical scope of the work. Not part of the Toxic Substances Control Division, the new office, the Office of Procurement and Contracts, is an administrative unit of the department and is staffed with personnel who are more experienced in contracting procedures. The Office of Procurement and Contracts is responsible for ensuring that contracts meet state and federal requirements.

Despite its recent efforts to improve its awarding of contracts, however, the department is still experiencing problems in its procurement process. The department's procurement of zone contracts illustrates these problems.

Chapter 376, Statutes of 1984 (Senate Bill 1465), provides \$100 million in bond money for the cleanup of sites on the list of hazardous substance release sites for remedial action adopted pursuant to Health and Safety Code Section 25356. The department intended to select up to three contractors in each of three regions or zones in California. These contractors would conduct cleanup investigations, feasibility studies, and laboratory analyses, prepare remedial action plans, and implement or oversee remedial actions. The department appropriately advertised its intent to contract in the California State Contracts Register and sent out a standard request for proposal (RFP) for all zones. In response to the RFP, the department received proposals from 16 different contractors, with most contractors submitting proposals for more than one zone.

In evaluating the proposals and qualifying the proposers, the department awarded points based upon the contractors' technical proposal. Of the 16 firms submitting proposals, 6 failed to meet the minimum requirements of the RFP and were, therefore, eliminated. The department asked the remaining 10 firms to submit business proposals indicating their prices for labor, laboratory tests, and equipment. The proposers were also to list as a percentage of total cost the rate for profit and overhead costs.

The department calculated final scores for each proposer, ranked each proposal, and decided to award contracts to nine of the ten qualified proposers. Seven of the nine firms signed contracts for the period from June 1, 1985, to December 1, 1986. The contract awards for each zone ranged from \$2.1 million to \$6.4 million. Two of the nine firms offered contracts did not sign them because the department rejected the firms' request to be released from liability for damages resulting from work performed under the contract.

The department allowed firms to submit proposals for more than one zone but decided to limit the awarding of contracts to only one zone per firm. The department intended to award contracts to up to nine different proposers, but only ten proposers qualified for evaluation of the business proposals and selection as a contractor. In effect, therefore, there was no real cost competition because the department offered contracts to nine of the ten qualified proposers at the rates included in their business proposals. These nine firms

received contracts regardless of the prices they bid. Public Contract Code Section 10344 requires agencies to give substantial consideration to the proposed contract price in relation to other criteria. We did not find any evidence that the department attempted to determine the reasonableness of the proposed prices. As a result, the department selected proposers that did not necessarily receive the highest scores or bid the lowest prices. For example, in the north coast zone, the proposer that ranked sixth in total points and submitted the sixth highest cost proposal received a contract.

Public Contract Code Section 10344 and State Administrative Manual Section 1213 state that agencies must award contracts to the responsible bidder with the lowest price or to the bidder with the highest scored proposal. However, both the Public Contract Code and the State Administrative Manual also allow an agency to reject all bids when it determines that the bids are not really competitive. They further state that an agency is not required to award a contract if the agency receives no proposals containing bids offering a reasonable contract price. The department could have exercised its option to reject all ten bids and asked the ten firms to submit revised business proposals.

In addition to not obtaining the most reasonable prices for the zone contracts, the department prepared zone contracts containing some vague payment provisions. The RFP required proposers to bid rates for specific work components, including various rates for labor,

laboratory tests, and equipment as well as percentages for profit and overhead. However, the RFP and the contract did not require the contractor to specify the cost components of the overhead percentage. As a result, there is the potential for disputes between the department and the contractors as to the classification of such items as photocopying, computer and word processing, telephone calls, and postage.

State Administrative Manual Section 1212.2 requires each contract to clearly express the amount to be paid and the basis upon which any payment is to be made. Because the basis for determining overhead in these contracts is vague, contractors could charge the State twice for the same costs, once as a percentage of overhead and again as "other direct costs." These are multimillion dollar contracts, and the potential exists for significant amounts of excess charges by and payments to contractors.

Finally, zone contracts do not comply with all federal contract regulations. Although the primary funding source for these contracts is state money, the department would like to use zone contracts in the future to perform work under federal cooperative agreements. Consequently, the department attempted to meet all federal requirements in procuring its current contracts. However, the department failed to do so. For example, the contracts contain "cost-plus-percentage-of-cost" payment provisions that are specifically prohibited by the Code of Federal Regulations (40CFR33.285). In

procuring the contracts, the department required proposers to bid profit and overhead separately as a percentage of labor costs. The department contends that the payment provisions essentially conform to federal requirements and that the net effect of the provisions is the same as that of accepted federal labor/hours contracts. However, unless the department resolves this issue with the EPA, the State may lose the ability to be reimbursed by the EPA for work done by zone contractors on federal Superfund sites.

The department continues to have problems in its contracting because it has not fully implemented an appropriate methodology for writing complete RFPs, evaluating RFPs, and writing contracts that will comply with federal regulations.

#### CONCLUSION

The Department of Health Services is not contracting in accordance with state and federal requirements. The department is authorizing some contractors to work without a valid contract and is not complying with requirements for competitive bidding and negotiating prices. Furthermore, the department has inappropriately used the "imminent and substantial endangerment" exemption. Finally, most of the department's contracts do not contain all of the standard language required by the State or the federal government, and some have vague contract provisions.

In an effort to improve its award of contracts, the department changed its procurement procedures and established the Office of Procurement and Contracts, which is staffed by personnel who are experienced in contracting procedures. However, the department still exhibits some of the procurement deficiencies that existed before it attempted to improve its contracting.

### RECOMMENDATIONS

The Department of Health Services should continue to use the Office of Procurement and Contracts to contract for toxics-related services. However, the department should provide this office with an experienced and fully qualified contract administrator. In addition, the department should require the Office of Procurement and Contracts to summarize all applicable state and federal requirements and prepare a manual or checklist against which to judge contracts before they are approved. Further, the department should ensure that its own contracting staff are fully trained and that they adhere to state and federal contracting requirements. Finally, the department should use the "imminent and substantial endangerment" exemption only in those instances that are justified.

Additionally, the department should assure that all appropriate state and federal contract clauses are included

and that vague contract language is clarified when it reprocures the zone contracts. In the interim, the department should use task orders to correct the deficiencies we identified in the current zone contracts.

Also, the reprocurement of the zone contracts should assure competition by following a two-step procurement process, including simultaneous submission of contractors' technical and business proposals. If insufficient responses are received to effectively assure competition, the department should negotiate the prices with the qualified contractors.

## II

### THE DEPARTMENT OF HEALTH SERVICES' CONTRACT MANAGEMENT IS DEFICIENT

The Department of Health Services has poorly managed the State's contracts for the cleanup of hazardous waste sites. For example, the department paid for inappropriate costs, made payments twice for the same personal services and equipment, and allowed contracts to continue after it was not economical to do so. Because the department did not regularly monitor the work of its contractors, eliminate duplicate payments, or verify that contractors performed the work they were required to do, the State has incurred at least \$1.4 million in questionable or unreasonable costs. Additionally, although the department terminated its contracts for the McColl Hazardous Waste Disposal Site in November 1985, the State incurred approximately \$1 million in unnecessary costs from June 1985 through October 1985 because the department did not terminate the contracts sooner. Finally, the department does not always pay for labor, equipment, or material at the rates included in the contract, it does not always account for and track charges for different contract items, and it sometimes delays payments to contractors. Consequently, the department has paid contractors more than it should have, and it has jeopardized the progress of work at one hazardous waste site. After we brought these problems to the attention of department officials, the department halted a \$557,982 payment to one of its contractors.

Management Of Contracts For  
The McColl Hazardous Waste Site

The McColl Hazardous Waste Disposal Site represents the largest effort approved by the EPA to excavate and dispose of hazardous waste. The cleanup was expected to take up to 17 months at a projected cost of \$21.5 million. The department has not, however, adequately managed this cleanup project. The department paid inappropriate costs for labor, equipment, and material, made payments twice for the same personal services and equipment, and allowed the contracts to continue after it was not economical to do so. As of November 1, 1985, the State had been billed approximately \$7.4 million for work at the McColl Hazardous Waste Disposal Site. At least \$1.4 million of this total is for questionable or unreasonable costs, and approximately \$1 million is for unnecessary costs because the department did not terminate the contracts sooner.

In August 1984, the department contracted with Canonic Engineers, Inc., to remove hazardous waste from the McColl Hazardous Waste Disposal Site. The contract called for \$1.9 million in "mobilization" costs. "Mobilization" includes the planning, personnel, and equipment needed to begin work. The contract allowed Canonic Engineers, Inc., to bill the mobilization items as a lump sum based upon the percentage of the work completed. The contract specified that following the receipt of written monthly progress reports, the State would reimburse the contractor monthly, in arrears, for actual expenditures based on lump sum and unit prices in accordance with other provisions of the contract.

In billing the State for reimbursement, Canonie Engineers, Inc., was to submit progress reports describing the work completed and invoices supporting the costs incurred or substantiating the value of items included on the invoice. For invoices from September through December 1984, Canonie Engineers, Inc., billed the State \$1.5 million for mobilization costs. However, in its request for portions of its lump sum payment for mobilization, Canonie Engineers, Inc., included items for which it had not yet incurred any costs and items that were not available to perform work. Our review of equipment purchase invoices, equipment delivery dates, subcontractor billings, and project progress pictures shows that Canonie Engineers, Inc., billed for a percentage of work completed before having completed that amount of the work. The department paid these invoices without requesting a schedule of values or proof of all actual costs and without requesting substantiation of the actual work completed.

For example, on October 1, 1984, Canonie Engineers, Inc., billed the State \$408,000 for an air enclosure. On December 3, 1984, the State paid \$367,200 of this bill, withholding 10 percent for retention. However, Canonie Engineers, Inc., did not order the air enclosure until November 7, 1984, paying a deposit of \$104,870 on November 13, 1984, and the remaining amount on April 5, 1985, four months after Canonie Engineers, Inc., was reimbursed by the State. Moreover, for September 1984, Canonie Engineers, Inc., included in its justification for partial payment of the lump sum for mobilization two pieces of heavy equipment that it claimed to have purchased to perform

work under the contract. However, Canonie Engineers, Inc., leased with an option to purchase rather than purchased the equipment, and the equipment was not available to perform work until December 1984. Furthermore, Canonie Engineers, Inc., did not actually make any payments until January 1985. The total value of this equipment was \$381,000. According to Canonie Engineers, Inc., the contract does not require the contractor to pay cash for equipment before billing for lump sum items completed under the contract. At the department's request, the Radian Corporation, the original project coordinator, reviewed the invoices that included the costs of the air enclosure and the heavy equipment. The Radian Corporation recommended that the department not pay for these costs until the air enclosure and equipment had been delivered to the site. The department did not accept this recommendation, however.

On January 3, 1985, the EPA's administrator decided to require that wastes from the McColl Hazardous Waste Disposal Site be placed in a double-lined hazardous waste disposal facility, as specified by new 1984 Resource Conservation and Recovery Act standards. This and other problems at the McColl Hazardous Waste Disposal Site delayed the start of site cleanup. In the January 1985 invoice, Canonie Engineers, Inc., began billing the State for delay and standby costs, but at least two items included in these costs were questionable.

First, in January 1985, Canonie Engineers, Inc., began billing the State \$91,000 per month in delay costs for "extended home office

overhead," which represented indirect costs generated by Canonie Engineers, Inc.'s., home office. In June 1985, the Radian Corporation informed the department that the monthly charge of \$91,000 for overhead costs was unreasonable because it was not allowed by the contract. However, on July 9, 1985, the department obtained an opinion from its legal counsel stating that delay costs for "extended home office overhead" could be negotiated with Canonie Engineers, Inc., under the contract. On September 11, 1985, the department issued a \$910,000 change order to the contract with Canonie Engineers, Inc., to pay it for "damages" incurred during the delay from January through October 1985. This change order authorized the payment of \$728,000, representing 80 percent of the total; the balance, approximately 20 percent, was held subject to audit to determine actual overhead costs. The amount of the damages was based upon Canonie Engineers, Inc.'s, calculation of the proportion of estimated home office overhead that it attributed to the contract with the State.

In calculating damages, Canonie Engineers, Inc., used a formula that it stated had been used in similar situations by the courts to assess delay charges during suspension of work. By issuing the change order, the department established this formula as the method of determining Canonie Engineers, Inc.'s, actual damages. However, this formula did not ensure that the amount paid to Canonie Engineers, Inc., for damages would represent actual damages sustained during the delay. Additionally, the amount of damages that Canonie Engineers, Inc., derived under the formula could increase if Canonie Engineers,

Inc., increased its overhead expenses. For example, damages could increase if Canonie Engineers, Inc., chose to increase the amount of profit sharing paid to its employees or if its parent corporation increased the management fee it charged its subsidiary. We believe that damages should be based on reasonable overhead fees and profits foregone as a result of the delay.

Second, Crosby and Overton, Canonie Engineers, Inc.'s, subcontractor, proposed to charge the State \$135,000 per month in standby costs for the 22 tractors and 40 trailers that it planned to use at the site. Crosby and Overton agreed to accept \$75,000 per month if the tractors and trailers could be used elsewhere during the delay. The Radian Corporation, in conjunction with Black and Veatch, Inc., its engineering subcontractor, reviewed the reasonableness of these standby costs and concluded that the \$75,000 in monthly standby costs would have been reasonable only if the tractors and trailers had been available at the McColl Hazardous Waste Disposal Site. The Radian Corporation said that the department should negotiate a more reasonable price if permission is granted to use the equipment on other jobs. The chief of the Toxic Substances Control Division's Program Management Section granted Crosby and Overton permission to use the equipment on other jobs and agreed to the \$75,000 per month in standby costs. We could not determine if the \$75,000 per month was a reasonable amount for damages caused by the delay without knowing the potential value of using the equipment elsewhere. Between January 1, 1985, and October 31, 1985, the State was billed nearly \$2.3 million in delay and

standby costs. As of October 31, 1985, the State had paid \$1.5 million of this total.

In addition, the State appears to have made payments twice for the same personal services and equipment. For example, by authorizing change orders, the department allowed Canonie Engineers, Inc., to bill the State for personnel used for special projects even though the State continued to pay operating costs for some of these same personnel. In one case, the State was billed at least \$45,000 for the services of three people working at the McColl Hazardous Waste Disposal Site between January and July 1985. These people were part of an on-site management team; therefore, portions of their cost were included under the original contract. Also, portions of their time were included and under contract change orders for special projects. Canonie Engineers, Inc., stated that the special project's invoices were for excess time required by the contractor as a result of the extra work requested by the State. However, we question the reasonableness of the total charges for these three people because the State paid for part of their time on special projects and for other parts of their time at the McColl Hazardous Waste Disposal Site even though work was curtailed at the site at that time.

It also appears that Canonie Engineers, Inc., included the purchase of various pieces of heavy equipment in its justification for billing portions of the lump sum mobilization item. Similarly, it justified under another lump sum bid item the purchase of an air

enclosure. Subsequently, Canonie Engineers, Inc., billed the State \$295,000 in standby charges for this equipment and the air enclosure between January 1985 through October 1985. Canonie Engineers, Inc., believes that the State did not gain ownership and lease rights to this equipment and air enclosure under the lump sum provisions of the contract and that Canonie Engineers, Inc., was therefore entitled to the monthly standby charges for these items.

Finally, the State allowed the contracts at the McColl Hazardous Waste Disposal Site to continue after it was not economical to do so. On May 31, 1985, the Superior Court of Kern County ruled that the department must comply with the California Environmental Quality Act regarding work at the McColl Hazardous Waste Disposal Site. The court order required the department to determine the environmental impact of dumping the waste from the McColl Hazardous Waste Disposal Site, and it precluded the department from authorizing contractors to perform any work at the site until an environmental impact report was approved. Since the department knew that it would take at least 12 months to prepare the environmental impact report and because the department was incurring operating, delay, and standby costs averaging approximately \$315,000 per month, the department should have exercised its option to notify its contractors by June 1, 1985, that their contracts would be terminated within ten days. Instead, however, the department continued to incur costs under these contracts until at least October 1985, five months later. In November, the department issued a notice of termination to the Radian Corporation and Canonie

Engineers, Inc. The department's contract termination proceedings were prompted by the EPA's withdrawing federal funds for cooperative agreement contracts associated with the McColl Hazardous Waste Disposal Site.

On February 27, 1986, we discussed the results of our review with representatives of the department. On February 28, 1986, the department stopped the most recent payment issued to Canonie Engineers, Inc. This payment totaled \$557,982.

#### Monitoring Of Hazardous Waste Contracts

The department is neither providing regular on-site monitoring nor always able to verify that contractors performed the work specified in their contracts. Consequently, the State is paying for services that it did not receive.

California's Public Contract Code describes the manner in which state agencies are to pay contractors for their work. Section 10261 of the Public Contract Code states that an agency will not make payments in excess of a certain amount of actual work completed. State agencies, such as the Department of Transportation and the Department of General Services' Office of the State Architect, that let contracts for public construction projects typically appoint an on-site project manager to monitor the contractor's progress and performance.

Although the department contracts with different firms throughout the State to provide a variety of services or perform various kinds of work, the department does not adequately monitor these contracts at the work site. For example, on June 1, 1984, the department entered into a contract with the Radian Corporation to monitor the work of Canonie Engineers, Inc., at the McColl Hazardous Waste Disposal Site in Fullerton. On August 21, 1984, the department relieved the Radian Corporation of the monitoring responsibilities and decided to have department staff monitor the work. Then, on November 12, 1984, the department decided to monitor the work at the McColl Hazardous Waste Disposal Site from Sacramento rather than at the site in Fullerton. Our review of the calendar of the department's project monitor shows that the project monitor was at the McColl Hazardous Waste Disposal Site only 25 days during the five months between January and May 31, 1985.

The lack of regular on-site monitoring contributed to the contract management problems discussed in the preceding section. Regular on-site monitoring would have enabled the department to evaluate the amount of work that contractors actually performed and thus determine the basis for payment to contractors. As mentioned earlier, for example, Canonie Engineers, Inc., was paid by the State for costs that it had not yet incurred and for items before they were available to perform work. The State's failure to provide regular on-site monitoring also jeopardizes its eligibility for \$21.5 million in future federal reimbursements. The cooperative agreement between

the department and the EPA for cleanup work at the McColl Hazardous Waste Disposal Site requires the department to maintain a representative at the site full time.

In another instance, the department contracted with the IT Corporation to provide responses to hazardous waste emergencies throughout the State. We reviewed 20 invoices submitted by the IT Corporation and found that the department could not determine the amount of work actually performed in 6 of these invoices. Without an on-site monitor, the department cannot be sure that the labor, equipment, and material for which the contractor has billed the State were in fact used at the site. We determined that the department paid the IT Corporation over \$500 for labor that the IT Corporation did not use in responding to hazardous waste emergencies. We brought this to the attention of the IT Corporation, which said it would issue a credit to the State for the full amount.

In explaining the department's inability to verify the amount of labor, equipment, and material used, an emergency response liaison officer for the department said that the department did not have sufficient personnel to monitor the work at each hazardous waste emergency site. However, we found no evidence that the department had ever requested additional personnel to provide this monitoring. The liaison officer further stated that local governments requesting emergency responses can often verify the labor, equipment, and material used at the site. However, local governments did not always provide this verification in the past.

## Payments To Contractors

The department does not always pay for labor, equipment, and material at the rates included in the contract. In addition, the department does not always account for and track charges for different contract items, and it sometimes delays payments to contractors. As a result, the State has paid more than it should, and in one case, it has jeopardized the progress of cleanup work at a hazardous waste site.

Hazardous waste contracts state the rates that the department should pay for goods and services and the method by which the contractor should bill for its costs. The contracts also identify those costs that are eligible for payment. The department is responsible for reviewing contractors' invoices and identifying those costs that are not eligible for payment to ensure that the State pays only costs that are reasonable. State Administrative Manual Section 8422.1 requires agencies to determine that contractors' invoices comply with the provisions of the contract, that invoices containing errors are corrected or returned to the contractor, and that payments have not already been made.

The department's contracts contain payment provisions. For example, the department's contracts with the Santa Ana Watershed Project Authority and the Radian Corporation state that progress payments will be made in arrears and at the completion of tasks, but not more often than once a month. The department's contract with the

Santa Ana Watershed Project Authority also requires payment within 60 days following receipt of the contractor's invoice.

However, because the department is not adequately reviewing invoices submitted by contractors, the department is paying more than what is stipulated in its contracts. We examined a sample of contractors' invoices for all ten of the contracts we reviewed for contract compliance and found rate discrepancies in three of these contracts. For example, the department overpaid the Radian Corporation \$4,700 for overhead costs at the McColl Hazardous Waste Disposal Site. The rate billed by the Radian Corporation was over 40 percent higher than the field rate proposed by the Radian Corporation. When we brought this discrepancy to the attention of the Radian Corporation, the Radian Corporation agreed that the billing was at a higher rate and indicated that it was aware of the error and that it was preparing an adjusted billing to reflect the proper rate.

In another case, the department paid the IT Corporation for labor, equipment, and material at rates higher than those specified in the contracts. As a result, the State paid \$680 more than it should have for labor, equipment, and material. We also brought this to the attention of the IT Corporation, which said it would issue a credit to the State for the full amount.

In addition, the department did not account for and track changes for different contract items. For example, the department

received an invoice from Canonie Engineers, Inc., for approximately \$1.9 million for work and delay costs at the McColl Hazardous Waste Disposal Site. The department did not pay approximately \$786,000 in charges, which include contract retention amounts, unapproved items, and disallowed costs, and forwarded a payment for \$1.1 million. However, the department did not indicate to Canonie Engineers, Inc., which charges had been reduced and why they had been reduced.

The department's failure to adequately account for and track charges for different contract items means that the department could be billed for costs that it has already paid. Furthermore, because the department does not provide detail on which charges have been reduced, a contractor cannot determine which charges have been paid by the department and can only speculate about why some have been reduced.

Finally, the department is delaying payments to contractors. In one instance, the department delayed payment on or did not pay 13 invoices submitted by the Santa Ana Watershed Project Authority. Although the department was required to pay invoices within 60 days of receipt, for 6 of these invoices, the department took from 66 to 156 days to pay the contractor. Furthermore, as of February 13, 1986, the department had still not reimbursed this contractor for the remaining 7 invoices it had received as of December 5, 1985. Because of late payments by the department, the Santa Ana Watershed Project Authority was unable to use state money to pay its subcontractors that were working on the Stringfellow Toxic Waste Disposal Site. These

subcontractors threatened to discontinue work unless they were paid for the work they had completed, thereby potentially delaying progress on the cleanup of this facility. To prevent this delay, the Santa Ana Watershed Project Authority was forced to use its own funds to pay the subcontractors until the department forwarded the payments that were overdue.

Some of the delays in the payment of invoices have resulted because the department has requested documentation that is often not required by the contract. In one instance, for example, department officials requested information on employee salaries even though this information was not required under the terms of the contract. Department officials could not explain why some invoices had been delayed during the department's technical and accounting review processes.

#### CONCLUSION

The Department of Health Services is not effectively managing its hazardous waste contracts. The department paid the excavation and hauling contractor at the McColl Hazardous Waste Disposal Site for questionable costs, made payments twice for the same services and equipment, and allowed contracts at the McColl Hazardous Waste Disposal Site to continue when it was not economical to do so. Furthermore, the department is not regularly monitoring its contracts to

ensure that work is performed. Consequently, the department may pay at least \$1.4 million in questionable and unreasonable costs at the McColl Hazardous Waste Disposal Site. In addition, the department does not always pay the correct contract rates for labor, equipment, or material, and it does not always account for and track charges for different contract items. As a result, the State has paid contractors more than it should. Finally, the department sometimes delays payments to contractors, and in doing so it has jeopardized the progress of cleanup work at one hazardous waste site.

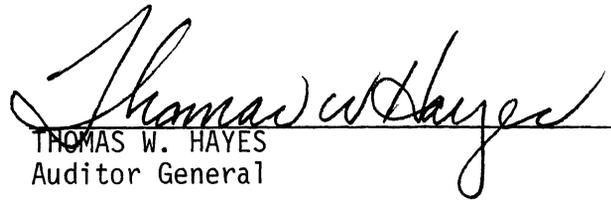
#### RECOMMENDATIONS

The Department of Health Services must improve its management and monitoring of hazardous waste contracts. The department should be sure that a representative of the State is on site when work at a hazardous waste site is being performed for the State. The representative should be a state employee or an independent contractor properly trained in project monitoring. On emergency response incidents, the State should either assure that the representative of the local government requesting such assistance monitors the work of the contractor, or the department should utilize Department of Health Services regional employees or other state agency employees paid for under interagency agreement. In addition, the department should pay its contractors only for actual work performed and only at the rates included in the contracts.

The department should immediately undertake termination or closeout audits of the major contractors at the McColl Hazardous Waste Disposal Site to identify and collect all payments made in excess of contract requirements and to recover all duplicate payments and payments for work that was not performed. In those instances when the contractor billed for equipment in advance of delivery to the site, the department should negotiate a reasonable interest charge that the contractor should pay for the unreasonable use of state and federal funds. Finally, the department should account for and track all payments to contractors, and it should not delay unnecessarily its payments to contractors.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

  
THOMAS W. HAYES  
Auditor General

Date: March 12, 1986

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**LIST OF ALL HAZARDOUS  
WASTE CONTRACTS REVIEWED**

<u>CONTRACTOR</u>	<u>CONTRACT NUMBER</u>	<u>CONTRACT PERIOD</u>		<u>ORIGINAL CONTRACT AMOUNT</u>	<u>APPROVED AMENDMENTS &amp; CHANGE ORDERS DOLLAR AMOUNTS</u>	<u>AMOUNT PAID BY DHS</u>	<u>REVIEWED DHS CONTRACT PROCUREMENT</u>	<u>REVIEWED DHS CONTRACT COMPLIANCE</u>
		<u>FROM</u>	<u>TO</u>					
Emergency Response Contracts:								
IT Corporation	82-80062	03/01/83	06/30/83	\$ 100,000	\$ 356,000	\$ 163,395	X	X
IT Corporation	84-84402	01/01/85	06/30/86	550,000	--	28,310	X	X
EPA Cooperative Agreement Contracts:								
Canonie Engineers, Inc.	83-82066	06/01/84	12/31/86	17,880,000	(882,000)*	4,357,015		X
James E. Danner Construction, Inc.	83-81944	12/01/83	11/30/84	731,500	324,334	1,011,725		X
Harding Lawson Associates	83-81867	09/01/83	06/30/85	764,500	--	510,661		X
IT Corporation	82-80065	03/01/83	06/30/85	50,000	1,697,200	1,595,900		X
IT Corporation	84-84503	02/15/85	06/30/85	421,482	400,000	56,277	X	
JRB Associates	83-82028	12/01/83	05/01/85	1,567,945	4,359,689	3,277,763	X	
Radian Corporation	82-79905	10/15/82	12/31/83	399,426	286,436	2,271	X	
Radian Corporation	83-82086	06/01/84	12/31/85	1,402,005	77,148	162,408	X	
Radian Corporation	83-82088	01/01/84	06/30/84	9,600	--	2,102	X	
Santa Ana Watershed Project Authority	83-82079	05/01/84	12/31/84	31,000	--	31,000	X	
Santa Ana Watershed Project Authority	84-84256	08/21/84	06/30/85	1,310,000	3,229,153	3,209,303	X	
Non-Site Specific Contracts:								
Dialog Information Services, Inc.	84-84441	11/01/84	06/30/85	7,500	--	0	X	
ICF Consulting Associates, Inc.	84-84451	01/15/85	12/01/85	176,980	--	132,696	X	
National Library of Medicine	84-84442	11/14/84	06/30/86	7,500	46,232	0	X	
Site Specific Contracts:								
Woodward-Clyde Consultants	84-84580	06/17/85	12/17/85	422,277	--	0	X	
Zone Contracts:								
Canonie Engineers, Inc.	84-84541	06/01/85	12/01/86	4,290,162	--	0	X	
Radian Corporation	84-84537	06/01/85	12/01/86	6,435,243	--	0	X	
Tetra Tech, Inc.	84-84543	06/01/85	12/01/86	6,435,243	--	0	X	

\*Approximate

**THE DEPARTMENT OF HEALTH SERVICES' IMPLEMENTATION OF  
PREVIOUS AUDITOR GENERAL RECOMMENDATIONS ON CONTRACTING**

In January and June 1984, the Auditor General issued reports supplementing the information contained in earlier reports. This supplemental information dealt specifically with the Department of Health Services' contracting for hazardous waste management. Below are the recommendations from these two reports and a summary of the department's efforts to implement them.

"The Department of Health Services'  
Superfund Program: Follow-Up Information,"  
(Report P-343.1, January 23, 1984)

Recommendation #1

To clarify the responsibilities of all participants in the Superfund program contracting process, the Department of Health Services should develop and maintain a contracting procedures manual for Superfund program contracts that describes all steps involved in the contracting process.

Status

The department drafted a contract procedures manual for the Superfund program in February 1985. However, the department never formally

distributed the manual for use in procuring the Superfund program contracts. The chief of the Office of Procurement and Contracts stated that his staff are developing a procedures manual that will address federal as well as state and departmental contracting requirements.

#### Recommendation #2

To expedite the Superfund program contracting process, the Department of Health Services should continue to identify steps in the contracting process that can be performed concurrently or that can be eliminated.

#### Status

In its response to this recommendation, the department indicated that it had proposed implementing five specific remedies to expedite its contracting process. The department proposed (1) completing the fiscal review and approval while developing the contracts, (2) sending the draft contracts to the contractors earlier in the process, (3) notifying the contract management section of the proposal due dates when the request for proposal is finalized, (4) requiring evidence of contractor liability insurance earlier in the process, and (5) requesting budget revisions before review by the budget section. We did not verify that the department actually implemented these proposed remedies, but for the contracts we reviewed, we determined that the department reduced the average contract processing time.

### Recommendation #3

To further accelerate the Superfund program contracting process, the Department of Health Services should consider giving Superfund program contracts priority during departmental reviews.

### Status

The department established a priority processing system for Superfund program contracts. The priority system uses cover sheets that list due dates and completion dates for the processing and review of Superfund program contracts.

### Recommendation #4

The Department of Health Services should develop and implement an effective system for monitoring and scheduling Superfund program contracts. This system should establish milestones for all steps in the contract process, and it should monitor these milestones to ensure that they are achieved as planned. The Toxic Substances Control Division's weekly status report on contracts should identify these milestones so that management can identify delays and take corrective action.

### Status

The department has not yet implemented a contract management system that establishes milestones for all steps in the contract process or that detects any fiscal or workplan implementation problems. However, the department is developing such a system and is continuing to use a monthly report that supplies information on the development and status of the contract.

### Recommendation #5

In letting contracts, the Department of Health Services should follow procedures that meet the intent of provisions of the State Contract Act and the State Administrative Manual.

### Status

Although the department has made some improvements in its contracting procedures, as we discuss in section I of our current report, the department is not always contracting in accordance with state requirements.

"Contracts for Cleanup of the Stringfellow Toxic Waste Disposal Site: Follow-Up Information," (Report P-244.1, June 4, 1984)

Recommendation #1

To improve its contractor selection process, the Department of Health Services should clearly describe how the interview process, if used, will affect the selection of the final proposal.

Status

The department did not use interviews to evaluate and select a final proposal on those contracts tested by the Auditor General. However, in procuring the zone contracts, the department did include a provision in the request for proposal to use a clarification process.

Recommendation #2

The Department of Health Services should ensure that the evaluation formulas used to rank proposals are analytically sound.

Status

In procuring the zone contracts, the department properly applied evaluation formulas described in the request for proposal. However, as we discuss in section I of our current report, the department limited

the awarding of contracts to only one zone per firm, and only ten firms qualified for the nine zone contracts; consequently, there was no real cost competition.

### Recommendation #3

The Department of Health Services should reject proposals with material deviations from the request for proposal at the time the deviation is identified, and the department should explain in writing the reason for rejecting the proposal.

### Status

In testing the department's contracts, we did not identify any accepted proposals that should have been rejected because of material deviations from the request for proposal requirements. Also, in evaluating the zone contract proposals, the department adequately documented reasons for rejecting proposals and sent written notice to bidders whose proposals failed to meet the minimum requirements of the request for proposal.

## DEPARTMENT OF HEALTH SERVICES

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Thomas W. Hayes  
Office of the Auditor General  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Hayes:

On November 22, 1985, Governor Deukmejian asked the Auditor General to review "the adequacy of the Toxic Substances Control Division's contracting procedures at federal waste cleanup sites and include recommendations of procedural changes". He made this request because of his continuing desire to improve the State's response to toxic hazards. His goal, and mine, is to develop the most effective state cleanup program in the nation.

I would like to commend the Auditor General for the thorough and expeditious manner in which the Governor's concerns have been addressed. I am also pleased to have the opportunity to respond to the report, P-582.1, "The Department of Health Services Needs Better Control of Hazardous Waste Contracts".

Overall, the Department of Health Services agrees that it needs to continue to improve its control mechanisms with regard to hazardous waste contracts. Therefore, a number of the recommendations included in the report will be implemented as soon as possible. For example:

The Department intends to take immediate steps to improve the level of expertise of our contract staff. This includes assignment of a fully qualified contract administrator as well as experienced and well-trained contracts unit staff.

We will continue to take steps to insure that contract management processes fully comply with all applicable federal and state guidelines. This extends to provisions dealing with insuring maximum competition in contracting procedures, use of our emergency contract exemption authority, and preparation of contracts which include all necessary and required clauses.

In addition, the Department will immediately and aggressively conduct an audit of our contract with Canonic Engineers, Inc. for cleanup services at the McColl hazardous waste site. Any and all inappropriate charges to the State will be identified, and actions will be taken to recover any resulting payments that may have been made.

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The Department will also be taking immediate steps to insure that a representative of the State is on-site at hazardous waste sites when state contractors are performing work. We also intend to improve on site monitoring of work done on emergency response incidents.

Attached you will find additional comments with respect to specific findings and recommendations of this report. Because of the complexity of the many issues raised, we will continue to develop additional comments and responses, and we would welcome the opportunity to discuss some issues further with you and your staff.

Specifically, we would like to explore several areas of your report relating to actions of the Department with regard to contracts for toxic cleanup work at the McColl hazardous waste site.

For example, the report criticizes several specific payments DHS made to Canonie Engineers, Inc., including those for mobilization costs, home office overhead costs, and delay charges for the hauling subcontractor at McColl. These items are authorized by the State's contract with Canonie. The questions raised in the report address the issues of the timing and amount of the charges and payments. These questions can be answered definitively only through a further audit of the detailed documentation supporting the Canonie billings. As indicated above, we accept and support your recommendation to immediately conduct this audit and closely review the specific items mentioned in the report.

The report also criticizes the Department for delays in the termination of McColl site contracts once an environmental impact analysis had been ordered by a court prior to the cleanup work proceeding. Clearly, the Department could not have terminated McColl contracts immediately upon issuance of the court's decision without full consideration of potential avenues of appeal, possible alternative actions allowing some continued cleanup work, and a general assessment of the impact of contract termination on our fundamental goal of protecting the public health. EPA has supported our actions in this regard.

Finally, let me emphasize again that the paramount goal of our toxics control program is to take whatever actions are necessary to protect the public health from the potential hazards caused by toxic wastes in our environment. Indeed, some of the report's criticisms stem from efforts to speed up toxic cleanup and cut through red tape. To assist us in accomplishing our goals, the Governor requested your involvement in determining what steps

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need to be taken to improve our system of responding to toxic control issues. We thank you for your useful suggestions.

Sincerely,

  
Kenneth W. Kizer, M.D., M.P.H.  
Director

Attachment

DEPARTMENT OF HEALTH SERVICES RESPONSE TO  
AUDITOR GENERAL'S REPORT P-582.1,  
"THE DEPARTMENT OF HEALTH SERVICES NEEDS  
BETTER CONTROL OF HAZARDOUS WASTE CONTRACTS"

DHS Comments and Response to Part I

Auditor General Conclusion:

"DHS is not contracting in accordance with state and federal requirements."

DHS Response:

The audit report states, "Zone contracts do not comply with all federal contract regulations. Although the primary funding source for these contracts is state money, the Department would like to use zone contracts in the future to perform work under federal cooperative agreements. Consequently the Department attempted to meet all federal requirements in procuring its current contracts. However, the Department failed to do so. For example, the contracts contain "cost-plus-percentage-of-cost" payment provisions that are specifically prohibited by the Code of Federal Regulations (40 CFR 33.285). In procuring the contracts, the Department required proposals to bid profit and overhead separately as a percentage of labor costs. The Department contends that the payment provisions essentially conform to federal requirements and that the net effect of the provisions is the same as that of accepted federal labor/hours contracts. However, unless the Department resolves this issue with EPA, the State may lose the ability to be reimbursed by the EPA for work done by zone contractors on federal Superfund sites."

This paragraph of the audit report creates the impression that the zone contracts do not comply with all federal regulations by referring to payment provisions as an "example". In fact, the appropriateness of the payment provisions is the only significant area indicated by EPA in its informal response to our request for an audit of the procurement of the zone contracts. Further, in the informal response an EPA representative made the observation that if there were 20 possible points for a good procurement, the zone procurement probably had 19, the potentially missed point being payment provisions. It should also be noted that no final determination of the procurement's compliance with federal regulations has been made by EPA and that EPA staff have only

indicated that the payment provisions give the appearance of cost-plus-percentage-of-cost provisions. OPC has responded to this concern in a letter dated January 27, 1986 to the Environmental Protection Agency.

The audit report implies that the State is or will be losing federal funds if EPA withholds approval of the procurement. The Department has not issued and does not intend to issue task orders to zone contractors to work on Federal Superfund sites before EPA approval of the contracts is received.

Auditor General Conclusion:

"The department is authorizing some contractors to work without a valid contract ..."

DHS Response:

In an eagerness to get the work started in some cases, DHS staff has authorized work to begin before the contract was officially signed. DHS will not allow this in the future and will work to constrain its eager staff in this regard.

Auditor General Conclusion:

"DHS is not complying with requirements for competitive bidding and negotiating prices."

DHS Response:

The audit report states that "in a recent procurement effort for regional removal and remedial action contracts conducted by the Department's Office of Procurements and Contracts there was no real cost competition because the Department offered contracts to nine out of a total of ten qualified bidders at the rates included in their business proposals; DHS made no determination of reasonableness of the proposed prices; and the Department selected proposals that did not necessarily receive the highest scores or bid the lowest prices. Since the bids were not competitive and nothing requires the awarding of a contract if the agency receives no proposals containing bids offering a reasonable contract price, the Department should have rejected all ten bids and asked the ten firms to submit revised business proposals."

The Department of General Services (DGS) in a written decision as a result of a protest to the procurement upheld the validity of the selection and evaluation procedure chosen by the Department

and the manner in which the procurement evaluation and selection team applied the procedures contained in the RFP. DGS approved the seven contracts submitted to it for review and approval as a result of this procurement effort. (See Attachment A.)

With an RFP, the Department proposed to make multiple contract awards up to a maximum of three awards in three separate regions. Public Contract Code Section 10340 requires advertisement in the contract register and solicitation of all prospective bidders known to the procuring agency. If this is done and less than three bids are obtained, the procuring agency can seek a sole source contract. Otherwise, this section (with a few other express exceptions) requires receipt of a minimum of three bids for any contract to be awarded as a result of a formally advertised procurement. In such cases, adequate competition is presumed. The Department obtained bids from sixteen proposers (most submitting bids in more than one region) for up to nine contracts. More than three bids were received for each contract from these sixteen initial proposers. The three-bid minimum requirement was met on the basis of the bids submitted by these sixteen proposers.

The Department met the requirements of Section 10344 of the Public Contract Code and Section 1213 of the State Administrative Code in scoring bidders' technical and business proposals. This procurement was conducted pursuant to Public Contract Code Section 10344(c) which allows a contract to be awarded to a bidder whose combined technical and business proposals receive the highest score, even if that bidder's bid price is higher than that of another bidder. The Public Contract Code Section 10344(c) requirement that consideration be given to a bidder's proposed contract price in relation to other criteria has been interpreted by DGS to be satisfied if price evaluation is at least 20 percent of the overall score. That requirement was met by the scoring methodology contained in the RFP and utilized by the scoring team.

The Department awarded contracts to proposers receiving the highest scores as determined by the selection procedures set forth in the RFP and otherwise followed the requirements of Public Contract Code Section 10344(c). The Department considered the overall reasonableness of bid prices.

DHS is accepting the Auditor General's recommendation for a better trained and knowledgeable contract procurement and management staff. In any future instances when negotiation is the appropriate course of action, DHS will aggressively negotiate the best price for the State.

If it is determined that the Department's processes concerning the procurement of the zone contracts are incorrect in any regard, steps will be taken to insure that future procurements conform to all requirements of state laws and regulations.

Auditor General Conclusion:

"DHS has inappropriately used the 'imminent and substantial endangerment exemption'."

DHS Response:

The audit report states that "the 'imminent and substantial endangerment' provision in the Health and Safety Code which permits the Department to more quickly process its contracts by circumventing the normal state procurement procedures was inappropriately used to award two contracts totaling over \$1 million to the IT Corporation so that it would be available to respond to toxic incidents should they occur."

When the original off-highway contract was developed in 1982, the Department did use the exemption discussed in the audit report. However, during the procurement of its current off-highway contract, the Department did not use the exemption listed under Health and Safety Code Section 25358.5.

Auditor General Conclusion:

"Most of DHS' contracts do not contain all of the standard language required by the state or federal government and some vague contract provisions."

DHS Response:

The audit report states that "all seven of the contracts awarded under EPA cooperative agreements lacked one to eleven of the thirteen major state required clauses regarding equipment purchases, evaluation of contractor's performance, resolution of disputes, contract retentions, and purchase approvals, and two of the three contracts reviewed lacked state required contract clauses related to contractor, evaluation resolving disputes and contractor's record keeping."

The audit report does not state which thirteen state required clauses were lacking in which of the ten contracts awarded under EPA cooperative agreements, nor does the report cite applicable SAM or California code sections in support of the contention that these thirteen clauses are required. Our legal office has taken the position in the past, at least for the zone contracts (and has so informed DGS), that hazardous waste site characterization, remedial investigation and clean-up activities contracted for are, for purposes of interpreting state laws and regulations, services contracts with equipment and materials purchases being merely incident thereto. Some of the ten contracts awarded as a result of EPA cooperative agreements also fall into the services

contracts category. Some of the examples of clauses described as mandatory in the audit report appear to be state SAM and Public Contract Code requirements only for consultant services contracts (See Section 10370 Public Contract Code: evaluation of contractor performance), or public works contracts, construction or consultant services contracts. (See Sections 10240 and 10381(c) of the Public Contract Code and SAM Section 1204 pertaining to use of disputes clauses. SAM only recommends use of a disputes clause in services contracts.) Furthermore, contract retentions are considered discretionary in contracts for services or consulting services contracts (See Public Contract Code Sections 10346 and 10379). In short, after reviewing the examples mentioned in the audit report, it is not clear whether, in determining the list of thirteen mandatory contract provisions and applying them to each of the ten contracts, the auditors took into consideration the fact that each type of contract described in the Public Contract Code must meet a separate and distinct set of requirements.

If it is determined that state-mandated contract provisions have been left out of a particular type of contract, we expect that the Department's procurement manual and additional training of contract personnel will eliminate this deficiency in the future.

Auditor General Recommendation:

"DHS should continue to use the Office of Procurement and Contracts (OPC) to contract for toxics-related services."

DHS Response:

Agree. DHS will continue to use OPC to contract for toxics-related services.

Auditor General Recommendation:

"DHS should provide OPC with an experienced, and fully qualified contract administrator."

DHS Response:

Agree. DHS will provide OPC with an experienced, and fully qualified contract administrator.

Auditor General Recommendation:

"DHS should require OPC to summarize all applicable state and federal requirements and prepare a manual or checklist against which to judge contracts before they are approved."

DHS Response:

Agree. DHS will prepare a summary of all applicable state and federal requirements and a manual against which to judge contracts before they are approved.

Auditor General Recommendation:

"DHS should ensure that its own contracting staff are fully trained and that they adhere to state and federal contracting requirements."

DHS Response:

Agree. DHS will ensure that its own contracting staff are fully trained and that they adhere to state and federal contracting requirements.

Auditor General Recommendation:

"DHS should use the 'imminent and substantial endangerment' exemption only in those instances that are justified."

DHS Response:

Agree. DHS will use the "imminent and substantial endangerment" exemption only in those instances that are justified.

Auditor General Recommendation:

"The department should assure that all appropriate state and federal contract clauses are included, and that vague contract language is clarified, when it reprocures the zone contracts."

DHS Response:

Agree. DHS will assure that all appropriate state and federal

contract clauses are included, and that vague contract language is clarified when the zone contracts are reprocured.

Auditor General Recommendation:

"When zone contracts are reprocured, competition should be assured by following a two-step procurement process, including simultaneous submission of the contractors technical and business proposals. If insufficient responses are received to effectively assure competition, the Department should negotiate the prices with the qualified contractors."

DHS Response:

We have some concerns with this recommendation. Simultaneous submission of proposers' technical and business proposals is used in the RFP process, but is not included in the two-step process described in Government Contract Bidding, Second Edition, used in the regional contracts and in the procurement of the major Medical fiscal intermediary contracts. The two-step process specifically incorporates the submittal of the business proposal subsequent to the clarification and evaluation process of the technical proposal.

This two-step process is the best method to use in any procurement where the requirements and work are particularly complex and different.

The purpose of the clarification process is to help the Department understand and evaluate the technical proposal to ensure the Contractor's understanding of and agreement to fulfill state requirements. The result is that all competitors have increased chances of gaining a complete and equal understanding of all of the requirements of the work for which they will bid. The benefit is that there will be minimal or no misunderstandings upon which bids will be based. This reduces potential for protests to the award, difficulty in contract implementation and contract disputes.

If it is determined that the Department's interpretations of the two-step process procurements are incorrect in any regard, steps will be taken to insure that future procurements conform to all requirements of state laws and regulations. Please note that DGS has upheld the zone contract procurement. (See Attachment A-DGS Statement of Decision.)

Auditor General Recommendation:

"DHS should amend its task orders under the zone contract to

correct the deficiencies identified by the auditors."

DHS Response:

Agree. DHS has already developed a process to ensure that task orders are specific, establish reasonable levels of effort and costs, and comply with the contracts and applicable state law.

DHS Comments and Response to Part II

Auditor General Conclusion:

"The department paid the excavation and hauling contractor at the McColl Hazardous Waste Disposal Site for questionable costs, made payments twice for the same services and equipment, and allowed contracts at the McColl Hazardous Waste Disposal Site to continue when it was not economical to do so."

DHS Response:

A principal finding of fact that evidently led the Auditor to this conclusion concerns payment of the "extended home office overhead" to Canonie Engineers, Inc. The Auditor cites a statement from Radian Corporation that the "overhead" items were not allowable under the contract. Prior to negotiating Canonie's claim for delay costs, the Department's legal office reviewed the provisions of the Canonie contract and advised Department personnel that Radian's conclusion that "overhead" items were not allowable was based upon a misinterpretation of clear language in Canonie's contract. (See Attachment "B" for complete legal analysis and relevant contract provisions.) The legal office advised that contract sections 11.3.2 and 11.6.1 entitled Canonie to recover reasonable home office overhead expenses as part of a claim for increase in contract price made under Article 11.2 of the contract if such expenses were incurred as a result of performance delays caused by a suspension of work at the site. Based upon the advice of legal counsel, the Department negotiated a mutually acceptable price for overhead expenses associated with Canonie's delay claim and documented that agreement in a change order as required by Article 11.2 of the contract. EPA staff reviewed the change order submitted by the Department, back-up documentation and Canonie's certified cost and pricing data and on, September 9, 1985, granted approval subject to final contract closeout audit.

One item of billing questioned by the auditor related to standby costs for the Crosby and Overton tractors and trailers. The Contractor claimed \$135,000 per month for these particular standby costs. The Department negotiated this amount down to \$75,000 with the provision that these items could be used elsewhere. To the extent this equipment was used elsewhere,

thereby making the \$75,000 per month payment unreasonable, we will seek reimbursement via post-audit.

Another finding of fact that leads the Auditor to this conclusion concerns the payment to Canonie for the air enclosure and the heavy equipment. The Auditor states, "The Radian Corporation recommended that the Department not pay for these costs without adequate documentation. The Department did not accept this recommendation, however." Radian made a recommendation on June 5, 1985 concerning documentation for stand-by costs for equipment idled by a delay in starting work. The recommendation did not concern documentation of purchases. On June 18, 1985, the Department forwarded a request for documentation on this item to Canonie. Canonie responded with information on August 5, 1985 including: invoices for the purchase of tractors and trailers, support for additional operating costs, purchase price for each piece of equipment, date and type of acquisition, and estimated useful life of the equipment. The change orders for stand-by costs were not negotiated until the recommended documentation was received. Similarly, the report indicates the Department authorized payments totaling \$1.5 million for mobilization costs by December of 1984 when Canonie was not, in fact, "mobilized enough to begin excavating and hauling until June 1985".

The Department agrees that a portion of these invoices should not have been paid when they were paid without obtaining documentation of actual costs incurred. However, it should be noted that all of these costs were appropriate and fully authorized under the terms of the contract, even though the timing of the payment may have been flawed. We intend to review our payment processes to insure that this situation does not reoccur. Furthermore, during our detailed audit of the Canonie contract we will review these items to seek repayment plus interest for any unreasonable use of state and federal funds.

The report cites duplicate billings under the Canonie contract. The Auditor claims that \$45,000 for the services of three Canonie personnel should not be paid in change orders #5 and #8 because the cost of those personnel is already covered by (and Canonie had already billed under) the contract for these items. These two change orders have not yet been executed by the Department. They will not now be executed until a detailed audit of contractor's records insures that no duplication of payment will occur.

The auditor's other example of duplicate billing relates to equipment purchased by Canonie for this contract. The contract did not specify that equipment purchased for the site cleanup became the property of the State. This is consistent with the EPA cooperative agreement which provides that the State is not to take title to equipment purchased for cleanup at the McColl site. The contract called for payment of \$1.9 million for mobilization. Equipment purchase was incidental to that mobilization. The only

other costs associated with that equipment are standby costs incurred by Canonie due to suspension of work at the site. Payment to Canonie for costs of equipment idled by a delay is appropriate under this contract. Although this may represent a contractual obligation in this case, we will closely review this matter during our contract audit and seek to negotiate future contracts that do not include provisions which have this result.

The Auditor mentions that upon hearing of his findings, "the Department halted a \$557,982 payment to one of its contractors."

The Department considers this a prudent action until the Department has fully evaluated the Auditor's findings in regard to the contract.

Auditor General Conclusion:

The Department "allowed all contracts at the McColl Hazardous Waste Site to continue when it was not economical to do so".

DHS Response:

The Department took into account a number of factors in regard to the decision to continue the contracts and pay the attendant delay costs. These factors were:

1. It was not immediately apparent that the court decision would not be appealed. Decisions on the appeal of complicated court cases require appropriate deliberation and consultation.
2. Foremost in the priorities of the Department is a desire to mitigate the possible negative public health impact of the site on the citizens of Fullerton. Termination of the contracts for McColl and repeating the procurement process would have delayed the clean-up significantly. Avoidance of that delay was a major consideration.
3. EPA agreed with the decision to continue the contracts by participating in their 90 percent share of the cost. The EPA decision to terminate in October 1985 was precipitated by a shortage of Superfund money caused by the absence of funding authorized by Congress. EPA fully supported the continuation as long as there were funds available.
4. There was considerable speculation at the time about possible legislative or congressional action to alter the situation in such a way to allow the work to resume.

In summary, the DHS did not make this decision in a vacuum, and a careful review of all the facts provide considerable justification for the decision.

Auditor General Conclusion:

"... the Department is not regularly monitoring its contracts to ensure that work is performed."

DHS Response:

Although we agree additional monitoring efforts should be undertaken, DHS has made efforts to have much of this monitoring done by contract.

Auditor General Conclusion:

"The State has paid contractors more than it should."

DHS Response:

Although contractors may have received excessive payments, it is our intent to fully recover these amounts under the DHS post-audit authority. We agree that a reliance on post-audits for contract or payment compliance is not the most effective means of contract management. However, the possibility for recovery under post-audit is real and protects the State from excessive payments to contractors.

Auditor General Conclusion:

"The Department does not always pay the correct contract rates for labor, equipment, or material, and it does not always account for and track charges for different contract items."

DHS Response:

The DHS organized a Site Mitigation Management Unit in October 1985. The organization of this unit is for the exact purpose of addressing this concern.

Auditor General Conclusion:

"The Department sometimes delays payment to contractors."

DHS Response:

In the cases cited, the DHS acknowledges that some payments have

been slow. In the case of the SAWPA contract, the contractor performed work outside the contract without prior approval and without the proper change orders thereby contributing to the delays.

Auditor General Recommendation:

"The Department should be sure that a representative of the State is onsite when work at a hazardous waste site is being performed for the State."

DHS Response:

DHS concurs and will take steps to implement.

Auditor General Recommendation:

"On emergency response incidents, the State should either assure that the representatives of the local government requesting such assistance monitors the work of the contractor, or the Department should utilize DHS regional employees or other State agency employees paid for under interagency agreement."

DHS Response:

DHS has already essentially adopted this recommendation. DHS is now asking local government to verify the work and provisions have been made to have regional employees respond on site to emergencies. However, it should be noted that an emergency response is just that and the necessity for an on site state presence must not prevent a speedy and complete response to an emergency.

Auditor General Recommendation:

"... the Department should pay its contractors only for actual work performed and only at the rates included in the contracts."

DHS Response:

Of course, DHS concurs. The need to have the ability to amend contracts for a work task that often changes should also be recognized as an obvious necessity.

Auditor General Recommendation:

"The Department should immediately undertake termination or closeout audits of the major contractors at the McColl Hazardous Waste Site to identify and collect all payments made in excess of contract specifications, and to recover all duplicate payments and payments for work that was not performed."

DHS Response:

DHS concurs and will take immediate steps to begin such an audit.

Auditor General Recommendation:

"In those instances when the contractor billed for equipment in advance of delivery to the site, the Department should negotiate a reasonable interest charge and the contractor should pay for the unreasonable use of State and federal funds."

DHS Response:

DHS concurs. In those cases where the close-out audits discover such circumstances, the DHS will attempt to recover the funds plus interest owed to the State.

Auditor General Recommendation:

"... the Department should account for and track all payments to contractors, and it should not delay unnecessarily its payments to contractors."

DHS Response:

DHS concurs. The DHS is attempting to deal with the many process demands caused by the dual EPA-DHS roles in contract payment and management.

DEPARTMENT OF GENERAL SERVICES  
Executive Office, Suite 590  
915 Capitol Mall  
Sacramento, CA 95814  
Tel.: (916) 445-3828

JUL 18 1988



BEFORE THE DEPARTMENT OF GENERAL SERVICES  
OF THE STATE OF CALIFORNIA

In the Matter of Protest of the )  
Proposed Award of Contracts for )  
Uncontrolled Hazardous Wastes )  
at Various Sites )  
  
FLUOR TECHNOLOGY, INC. )  
ADVANCED TECHNOLOGY DIVISION, )  
  
Protestant, )  
  
v. )  
  
DEPARTMENT OF HEALTH SERVICES, )  
  
Awarding Agency. )

CASE NO. 85-59

STATEMENT OF DECISION

FOR PROTESTANT: FLUOR TECHNOLOGY, INC., MICHAEL T. KAVANAUGH, ESQ.  
DIANE R. SMITH, ESQ.

FOR PROPOSED AWARDEES: FLUOR TECHNOLOGY, INC., EMIL J. PARENTE, PRESIDENT  
ECOLOGY AND ENVIRONMENT, INC., RONALD L. FRANK, VICE PRESIDENT  
CANONIE ENGINEERS, INC., R. G. BRISETTE, PRESIDENT  
TETRA TECH, INC., ROBERT E. YELIO, PH.D., PRESIDENT  
CH2M HILL, B. G. HALL, VICE PRESIDENT  
METCALF & EDDY, INC., FRANKLIN L. BURTON, VICE PRESIDENT  
DAMES & MOORE, KENNETH A. STROM, ASSOCIATE  
RADIANT CORPORATION, A. T. TEN BROEKE, ASSISTANT VICE PRESIDENT  
UBE (JOINT VENTURE), JIM JORDAN

FOR AWARDING AGENCY : DEPARTMENT OF HEALTH SERVICES, THEODORA F. SIMPSON, ESQ.

This protest, filed under section 10345 of the Public Contract Code,  
relates to the proposed award by the Department of Health Services of contracts

for various services in the identification and implementation of remedial actions necessary to mitigate or eliminate the dangers of uncontrolled hazardous wastes at sites throughout the State of California.

#### PROTEST OF FLUOR TECHNOLOGY

This matter came on for hearing before Michael Kelley, designated hearing officer for the Department of General Services on June 25, 1985, at Sacramento, California.

The protestant and proposed awardee, Fluor Technology, was represented by Al Sacker, Raymond Dligal, Frank Collins, Michael Kavanaugh, Diane Smith, and John Burton.

The awarding agency, Department of Health Services, was represented by Theodora Simpson, Virgil Toney, Everett Uldall, Judi Frantz, Odette Nichohl, Stan Phillippe, Pilo Sacas, Marcia Sorrnick, and Carol Freels.

A proposed awardee, Radian Corporation, was represented by Murray Wells.

A proposed awardee, Metcalf & Eddy, was represented by Clinton Whitney.

A proposed awardee, UBE, was represented by Jeffrey Yarne and Jim Jordan.

A proposed awardee, CH2M Hill, was presented by Phil Hall.

A proposed awardee, Dames & Moore, was represented by Ken Strom.

A proposed awardee, Tetra Tech, was represented by Victor Yamada.

A proposed awardee, Ecology & Environment, was represented by Joe Petrilli.

On November 10, 1984, the Department of Health Services released RFP 84-045 which is the subject of this protest. As required by the RFP, technical proposals were due January 2, 1985, and business proposals were due February 7, 1985.

On May 30, 1985, a protest was filed by Fluor Technology, a proposed contract awardee.

A Notice of Time and Place of protest hearing was issued by the Department of General Services on June 10, 1985.

## ISSUES PRESENTED

The statutory grounds for the protest of contracts awarded under the provisions of Public Contract Code section 10344 are found in Public Contract Code section 10345 and are as follows:

A. The agency failed to follow the procedures specified in either subdivision (b) or (c) of section 10344.

B. The agency failed to apply correctly the standards for reviewing the format requirements or evaluating the proposals as specified in the RFP.

C. The agency used the evaluation and selection procedure in subdivision (b) of section 10344, but is proposing to award the contract to a bidder other than the lowest responsible bidder.

D. The agency used the evaluation and selection procedure in subdivision (c) of section 10344, but failed to follow the methods for evaluating and scoring the proposals specified in the RFP.

E. The agency used the evaluation and selection procedure in subdivision (c) of section 10344, but is proposing to award the contract to a bidder other than the bidder given the highest score by the agency evaluation committee.

## DISCUSSION OF ISSUES

RFP 84-045 established an award procedure under Public Contract Code section 10344 (c), for multiple contracts in each of three geographical regions. All proposals were ranked by region according to the highest total score. Proposers could submit a proposal for any or all of the three regional contracts. The second and third highest scorers in each region were also eligible for contract award in that the Department of Health Services reserved the right to enter into three contracts with three different contractors in each of the three geographical areas. The final score of a proposer consisted of a combination of a weighted technical proposal score and a weighted business proposal score.

In a Notice of Intent to Award dated February 21, 1985, proposers were notified that contracts were being awarded to first, second, and third tier contractors in each of the three regions as follows:

<u>Northern California</u>	<u>North Coast</u>	<u>Southern California</u>
1. Radian	1. CH2M Hill	1. Tetra Tech
2. Metcalf & Eddy	2. Canonie	2. Ecology & Environment
3. UBE	3. James & Moore	3. Fluor/weston

Paragraph 6.31, page 6-14 of the RFP requires each contractor to "furnish to the State a certificate of insurance stating that there is liability insurance presently in effect for contractor with a combined single limit (CSL) of not less than \$5,000,000 per occurrence."

Paragraph 6.32, page 6-15 of the RFP states as follows: "The contractor agrees to indemnify, defend, and save harmless the State, its officers, agents, and employees from any and all claims and losses accruing or resulting to any and all contractors, subcontractors, materialmen, laborers, or any other person, firm, or corporation who may be injured by the contractor in the performance of this contract."

Exhibit 6-1 of the RFP, page 2 of 2, which is the reverse side of the State's Standard Form 2 contract, reads at paragraph 1 as follows:

"The contractor agrees to indemnify, defend and save harmless the State, its officers, agents and employees from any and all claims and losses accruing or resulting to any and all contractors, subcontractors, materialmen, laborers and any other person, firm or corporation furnishing or supplying work, services, materials or supplies in connection with the performance of this contract, and from any and all claims and losses accruing or resulting to any person, firm or corporation who may be injured or damaged by the contractor in the performance of this contract."

On May 2, 1985, final contract documents embodying the above

referenced provisions were sent for signature by the Department of Health Services to all nine awardees set forth in the Notice of Intent to Award.

Because several awardees requested various alterations to the State's standard indemnification provision, the Department of Health Services allowed each contractor an opportunity to include a modifying provision referred to as paragraph H, in its contract.

Paragraph H states: "Notwithstanding the provision of paragraph #1 of the Standard Agreement, the State agrees, to the extent legally permissible and subject to the availability of funds, to hold harmless, indemnify and defend the contractor for any loss or liability for damages sustained by or on the part of any person or entity as a result of contractor's legal, non-negligent performance under this contract. In the event that any applicable legislation which limits or eliminates any liability otherwise applicable to contractor in connection with any aspect of this contract is enacted following execution of the contract, such legislation shall, to the full extent of its terms be extended to the contractor hereunder."

As of May 23, 1985, Department of Health Services had received signed contracts incorporating paragraph H from seven of the nine awardees.

From and after the above date, Department of Health Services has been unable to finalize mutually acceptable contracts with the third tier contractor in the Northern California Region, UBE, and Fluor/Weston, the third tier contractor in the Southern California Region.

The position of the protestant, Fluor, which is also a proposed contract awardee, may be summarized as follows:

The requirement that a contractor indemnify the State, and the placing of unlimited liability with the contractor is not a reasonable business arrangement. The potential liability from pollution and hazardous

substances incidents is such that it should be shared by the State of California.

Fluor asserts that pollution coverage insurance within the umbrella of a comprehensive liability policy is no longer available within the insurance industry, and even if such a policy were currently in effect and held by a contractor, such policy will lapse upon its term and no contractor will be able to obtain the same renewal coverage at a time which will definitely occur within the term of the 18-month contracts at issue.

Assuming the requisite insurance will not be available, the result will be unlimited liability exposure for contractors which will solely leave corporate assets as a source to meet pollution related risks and toxic torts, the consequence of which will be that the public will not be adequately protected. Such being the case, Fluor states no one bidder can be financially responsible given the specific RFP at issue and the specific contract at issue.

Because the factor of insurability is an element of financial stability and financial responsibility, the inability to get liability insurance for inherent pollution risks similarly reflects a lack of responsibility. Financial stability is a pass/fail factor in the RFP at page 5-18, and as such, the Department of Health Services has failed to follow the RFP in that it did not consider insurability as an element of financial stability. As to this issue, Fluor cites Public Contract Code section 10345 (d) as its basis for protest. "(d) The agency used the evaluation and selection procedure in subdivision (c) of section 10344 but failed to follow the methods of evaluating and scoring the proposals specified in the RFP."

In summary, Fluor indicated that its protest was timely filed, that it is desirous of being a contractor, and that it only wants a reasonable business arrangement and the ability to negotiate reasonable terms so that it is not burdened with unlimited liability.

The position of Health Services may be summarized as follows:

The Department of Health Services followed all requirements of the State Administrative Manual (SAM), including the SAM requirements pertaining to hazardous contracts, in its RFP and contract procedures. It has also followed all requirements of Public Contract Code section 10344, as well as all of the requirements of RFP 84-045.

The Department of Health Services met with officers in the Department of General Services' Insurance Office specifically for the purpose of addressing insurance coverage, which has been a long-term problem in the area of toxic waste and pollution. Health Services also asserts that the protestant has not stated any of the grounds of protest as set forth in Public Contract Code section 10345, and that the protestant is solely speculating as to future occurrences with respect to insurance availability. Health Services states that all bidders were informed for some time by virtue of the terms of the RFP, of the need for insurance and the requirement of indemnification. Lastly, Health Services indicates that it found all proposed contract awardees to be responsible, including Fluor, that Fluor's protest was not timely filed, and that Health Services has been prepared to proceed with the contracts awarded to each of the nine contract awardees.

The Department of Health Services requested that the Department of General Services release for approval the seven signed contracts with the non-protesting awardees, on the basis that those contracts are outside of the scope of, and are not affected by, Fluor's protest of its own contract.

The summary position taken by the proposed awardees that were present was that each was anxious to perform its contract, that each had assumed a business risk in signing its contract, and that each was uncertain as to whether it could obtain in the future its current type of insurance upon its expiration.

## FINDINGS AND DECISION

In view of the submitted written materials and the presentation made during the course of the hearing, it is found as follows:

1. Public Contract Code section 10345 requires a protest to be filed prior to the contract award.
2. Public Contract Code section 10345 requires that a protest be filed by a bidder.
3. RFP 84-045 is severable, and may be segregated into separate and distinct RFP's, one for each of the three tiers in each of three regions.
4. Fluor Technology is a bidder solely with respect to the third tier RFP in the Southern California Region.
5. A contract award occurred for each of the nine awardees set forth in the Notice of Intent to Award when the final contract documents were tendered for signature to each awardee by the Department of Health Services in the May 3, 1985 letter signed by Virgil J. Toney.
6. The protest of Fluor, as to its contract and all other contracts, is not cognizable because its protest was filed after the award of its contract and all other contracts.
7. The protest of Fluor as to all contracts other than its own, is not cognizable because it is a bidder solely as the third tier RFP in the Southern California Region.
8. Based upon the aforementioned findings and as previously ruled by the undersigned at the hearing, all of the subject contracts, with the exception of the contract with UBE, and the contract with Fluor, are released for approval by the Department of General Services as being outside the scope of the protest at issue.

9. With respect to the third tier RFP for the Southern California Region, assuming that Fluor Technology filed a timely protest, Fluor has failed to demonstrate that any of the grounds of protest exist, as set forth in Public Contract Code section 10345.

10. With respect to all other RFP's, assuming that Fluor Technology was a bidder and filed a timely protest, Fluor has failed to demonstrate that any of the grounds of protest exist, as set forth in Public Contract Code section 10345.

11. The Department of Health Services properly followed the procedures specified in subdivision (c) of Public Contract Code section 10344.

12. The Department of Health Services correctly applied the standards for reviewing the format requirements and evaluating the proposals as specified in the RFP.

It is, therefore, decided that the protest of Fluor Technology, Inc., be, and the same is hereby denied.

DATED: July 11, 1985

  
MICHAEL KELLEY, HEARING OFFICER  
DEPARTMENT OF GENERAL SERVICES

DECLARATION OF SERVICE BY MAIL

I am over eighteen years of age, and not a party to the within entitled action; my business address is 915 Capitol Mall, Room 538, Sacramento, California. 95814: I served a copy of the attached \_\_\_\_\_

STATEMENT OF DECISION - PROTEST CASE NO. 85-59

on each of the following, by placing same in an envelope(s) addressed as follows:

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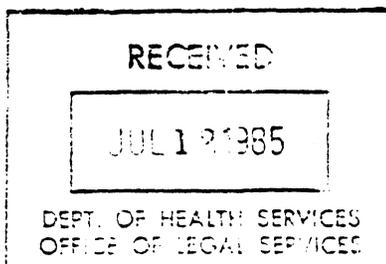
Mr. Franklin L. Burton, Vice President  
METCALF & EDDY, INC.  
1029 Corporation Way  
Palo Alto, CA 94303

(continued on next page)

Each said envelope was then, on JULY 11, 1985  
sealed and deposited in the United States Mail at Sacramento, California, the  
county in which I am employed, with the postage thereon fully prepaid.

I declare under penalty of perjury that the foregoing is true and  
correct.

Executed on JULY 11, 1985 at Sacramento, California.



*Franklin L. Burton*  
Declarant: Franklin L. Burton

DECLARATION OF SERVICE BY MAIL

Page 2.

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## ATTACHMENT B

Change Order Number One to Canonie's contract added thirteen mandatory federal contract clauses to that contract. Mandatory Clause #5 provides that if the department orders the contractor in writing to suspend, delay or interrupt all or any part of the contract work or if an act of the department or a failure to act suspends, delays or interrupts contractor's work for an unreasonable period of time, contractor shall be entitled to "an adjustment for any increase in the cost of performance [under the contract] (excluding profit) necessarily caused by such unreasonable suspension, delay or interruption". The increased costs must then be reflected in a written contract modification. A cost adjustment under Clause #5 is precluded if any other provision of the contract expressly provides for or expressly precludes an adjustment for any specific increase in cost of performance. Costs incurred more than twenty days before the contractor gives written notice of the act or failure to act involved are not recoverable. Contractor must assert his claim for a cost adjustment in writing "as soon as practicable after the termination of such suspension, delay or interruption, but not later than the date of final payment under the [contract]".\*

That same Change Order Number One substituted a new paragraph 15.1 to page 21 of the contract General Terms and Conditions. That paragraph allows the department to give verbal notice (confirmed in writing) of a partial or total suspension of work, it also provides for an increase in "contract price or an extension of the contract time, or both, directly attributable to any suspension if he makes a claim and is entitled to an increase or extension under the terms of this Contract".

Black and Vetch, Radian's subcontractor, reached a determination that Canonie should not be entitled to any increase in the contract price for home office overhead associated with Canonie's delay claim. That conclusion appears to have been based on the theory that the contract (under General Terms and Conditions Article 11 at 11.5) contained an unambiguous, express contract term within the meaning of mandatory Clause #5 and paragraph 15.1 which clearly excluded any home office expenses as an item of cost for purposes of pricing a contractor's claim for adjustment.

The department's legal office reviewed Article 11 in its entirety and determined that Article 11.3 contract language allowed the department to pay a contractor's "claim for an increase or decrease in the contract price" in one of three ways (1) application of contract unit prices where present (Article 11.3.1); (2) "by mutual acceptance of a lump sum" (Article 11.3.2) or (3) on the basis of determinations made in accordance with Article 11.4 through 11.8 (see Article 11.3.3). The third method of pricing described in Article 11.3.3 was not mandatory. Article 11.5 did not operate as an overall restriction on the department's ability to use the second method of pricing to reach

\*AUDITOR GENERAL NOTE: Because of its length, the copy of the contract that the department included in its response has not been reprinted. It is available for review at the Office of the Auditor General.

agreement on a mutually acceptable lump sum covering Canonie's delay claim. Nor did it require disallowance of home office overhead costs if the department determined that Canonie's cost and pricing proposal and other factors supported a claim for increased home office overhead costs.

The department's legal office further concluded that even if the third method of pricing the adjustment were used (Articles 11.4 through 11.8), Article 11.5 language did not, despite Black and Vetch's contentions in fact, preclude payment of home office overhead expenses at all. Rather, Article 11.5 stated that those items of expense would be considered part of the Contractor's Fee under Article 11.6 rather than as part of the Cost of Work as defined in Article 11.5. Since Article 11.6 allowed the department to compensate the contractor for overhead and profit (Contractor's Fee) either by a fee based on described percentages of the various portions of the cost of the work (see Article 11.6.2) or by arriving at a mutually acceptable fixed fee in negotiations with the contractor (see Article 11.6.1), the legal office advised that it would be appropriate for the department to consider home office overhead as an item of increased cost associated with the delay and attempt to reach agreement on the fixed amount to be paid. (See attached for relevant contract provisions.) \*

Canonie submitted certified cost and pricing proposal information in support of its claim. Canonie's attorney advised that the home office overhead expenses were computed using the "Eichleay formula". The legal office reviewed the appropriateness of using the Eichleay formula and, on the basis of independent research, determined that this formula was the formula most frequently used in construction contracts to price delay claims. (See Government Contract Changes, Federal Publications Inc., author Ralph C. Nash, Jr., First Edition and 1981 supplement, chapter 16, "Costs of Delays Related to Changes", pages 385 through 402 (pages 394-395 in particular; (attached) see also Eichleay Corp., ASBCA 5183, 690-2 BCA para. 2688, 2 G.C. para. 485.)

Utilization of the Eichleay formula is also consistent with the concept that, in pricing a delay claim, a contracting officer must base his/her decision on what constitutes a reasonable amount for a price adjustment on the best information available at the time price negotiation is taking place. Actual historical cost information must be used where available. Projections of cost are permissible when prospective pricing is necessary. Canonie provided actual historical cost and projected cost documentation in support of its Eichleay computation prior to price negotiation.

We also point out that, on July 8, 1985, a meeting was held between the EPA Inspector General and department staff regarding extended office overhead. At that meeting, EPA indicated that the extended overhead portion of Canonie's delay claim would qualify for funding under the cooperative agreement if proper documentation was provided. After the department negotiated a price for the delay claim with Canonie, the department submitted

\*AUDITOR GENERAL NOTE: Because of its length, the copy of the Government Contract Changes that the department included in its response has not been reprinted. It is available for review at the Office of the Auditor General.

the costs to EPA with a request for EPA review. In September of 1985, EPA notified the department that their Inspector General reviewed the documentation submitted including Canonie's certified "Cost or Price Summary" and granted approval pending final contract audit.

In summary, the auditors' reliance on Black and Vetch's contract interpretation is misplaced. The department stands by its interpretation of the contract, which has apparently received approval in principle from the U.S. EPA.

TS:cmw

cc: Members of the Legislature  
Office of the Governor  
Office of the Lieutenant Governor  
State Controller  
Legislative Analyst  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
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