

The Price Reduction Clause: An Overview of The Basics

by Thomas P. Barletta

The Price Reduction clause (“PRC”) is one of the most significant elements of a GSA Federal Supply Schedule (“FSS”) contract. It is important that contractors understand the requirements of the PRC and have systems and procedures in place that are adequate to ensure compliance.

I. The Clause

The PRC requires the contractor and contracting officer to agree on (1) a basis of award customer, and (2) the Government’s discount relationship to that customer. See GSA Acquisition Regulation (“GSAR”) 552.238-75(a). It also requires that relationship “[to] be maintained throughout the contract period.” Id. In other words, a contractor can trigger the PRC if it extends pricing or discounts to the basis of award customer in a manner that “disturbs” the pricing “relationship” between that customer and the Government. Id.; see also GSAR 538.272 (“[i]f a change occurs in the contractor’s commercial pricing . . . to the identified commercial customer . . . that results in a less advantageous relationship between the Government and this customer . . . the change constitutes a ‘price reduction’”).

Under the terms of the PRC, a price reduction occurs if the contractor

- i) Revises the commercial catalog, pricelist, schedule or other document upon which contract award was predicated to reduce prices;
- (ii) Grants more favorable discounts or terms and conditions than those contained in the commercial catalog, pricelist, schedule or other documents upon which contract award was predicated; or
- (iii) Grants special discounts to the customer (or category of customers) that formed the basis of award, ***and the change disturbs the price/discount relationship of the Government to the customer (or category of customers) that was the basis of award.***

GSAR 552.238-75(c)(1) (emphasis added). Note that the GSA regulations broadly define terms such as “discount” and “concession.” See, e.g., GSAR 552.212-70(a) (defining “Discount” as including rebates, quantity discounts, purchase option credits and any other terms or conditions that reduce the amount of money the customer ultimately pays).

To ensure that the Government gets the benefit of any price reductions, the PRC requires the contractor to report any price reductions given to the basis of award customer within 15 days of the effective date of the price reduction. See GSAR 552.238-75(b). In addition, when there is a “price reduction,” the contractor is required to give it to the Government with the same effective date and for the same period as available to the basis of award customer.

GSAR 552.238-75(c)(2).

Certain transactions involving the basis of award customer are outside the reach of the PRC, but these are limited to sales under firm, fixed-price, definite-quantity contracts in excess of the contract’s maximum order threshold (“MOT”). See GSAR 552.238-75(d)(1). In addition, sale of contract items to federal agencies at lower prices than provided under the GSA contract also fall outside the PRC, as do sales at lower prices that are caused by errors in quotation or billing, provided that the contractor can provide adequate documentation to the contracting officer. See id. (d)(2)-(3).

II. Interpretation and Application of the PRC

A. Case Law

The current version of the PRC went into effect in 1994, although it traces its origins to GSA’s 1982 MAS policy statement. However, case law interpreting and applying the current PRC is limited.

One relatively recent case, Invacare Corp., VABCA No. 6574, 02-2 BCA ¶ 32,040 (Oct. 3, 2002), illustrates some of the complexities associated with the PRC and the potential interaction of a contractor's proposal submissions and its conduct of contract negotiations with the subsequent application of the PRC.

In Invacare Corp., the contractor also sought to reach agreement with the VA that a particular customer (Apria Healthcare) would not be included within the contract's basis of award category (National Accounts). Invacare had given Apria Healthcare a greater discount than was available to the Government because Apria Healthcare had agreed to buy 90% of its requirements (estimated at \$50 million) from the contractor. In connection with its effort to exclude Apria Healthcare, Invacare, at the Government's request, submitted new pricing data (DSMD) to a contract specialist. The Government ultimately denied the contractor's request to exclude Apria Healthcare, taking the position that the customer was simply a merger of two companies that had previously fallen within the basis of award category of customer. The VA also subsequently conducted an audit and asserted that it was entitled about \$650,000 in price reductions based on the lower prices that had been given to Apria Healthcare.

While the discussions regarding the exclusion of Apria Healthcare from the basis of award class of customer were pending, the Government also issued a notice of its intent to exercise an option to extend the term of the contract with Invacare. Invacare responded by certifying that, other than Apria Healthcare, the basis of award category of customers had not changed and that the disclosed discount/pricing relationships also remained unchanged. Invacare also noted that it was in the process of submitting a new DSMD in connection with the discussions regarding Apria Healthcare. A Modification (No. 12) was ultimately issued

extending the term of the contract, making various changes not relevant here, and providing that “all other items and conditions of the contract remain unchanged.”

Invacare ultimately agreed that the Government was entitled to a price reduction based on the discounts extended to Apria Healthcare, but the parties disagreed on how it should be computed. In that regard, Invacare, relying on the DSMD that had been submitted in connection with the discussions regarding Apria Healthcare, took the position that the issuance of Mod. 12 had altered the price/discount relationships, cutting off its price-reduction liability.

The Board ultimately rejected Invacare’s position. It held that Mod. 12 did not alter the contract’s price/discount relationship. In doing so, it noted that the terms of the Modification were “clear on their face” in that they did not incorporate the new DSMD (submitted in connection with the discussions of Apria Healthcare) and provided that, other than certain listed changes, “all other items and conditions of the contract remain unchanged.” *Id.* at 158, 326. The Board also noted that while Mod. 12 was clear and therefore it was unnecessary to consider extrinsic evidence such as the contemporaneous discussions and actions of the parties, those actions did not show that they intended to change the price/discount relationship. In that regard, the Board pointed to the fact that the new DSMDs were submitted to a contract specialist who was not involved in the negotiations regarding Mod. 12, and not to the Mod. 12 contracting officer; that the evidence indicated that the parties had agreed to postpone dealing with the Apria Healthcare issue in negotiating Mod. 12 and had not otherwise addressed that issue in those negotiations; and, finally, that Invacare had waited too long to raise its “Mod. 12” argument.

B. What Does It Mean To Have “Disturbed The Relationship”?

A price reduction that gives the basis of award customer prices on relevant products that are *below* the prices disclosed to the GSA during the proposal and negotiation process will

trigger a price reduction. However, as noted above, the PRC requires the contractor to “maintain the relationship” between the prices given to its basis of award customer and the Government. As a result, reducing price to the basis of award customer can trigger a price reduction, even if the net price to the basis of award customer remains *higher* than the Government’s price. This can occur if, for example, there is a “gap” between the contractor’s disclosed prices to the basis of award customer and its GSA prices and the contractor offers a price reduction to the basis of award customer that narrows the gap; such a price reduction may be viewed as having “disturbed the relationship” between the basis of award class of customer and the Government. See generally 41 C.F.R. § 5A-73.217-5(c) (1982) (Example No. 1) (former GSA guidance providing examples of “equivalent price reductions” under a prior version of the PRC). Likewise, the Government might argue that the relationship has been disturbed where GSA has accepted a lower discount (higher price) than that given to the basis of award customer (e.g., dealers) and the contractor subsequently increases its discount (reduces the price) to that customer, thus *increasing the spread* between the GSA’s and the basis of award customer’s price/discount. See id. (Example No. 2).

III. Contracting Considerations

A. Pre-Award Considerations

As the Invacare decision indicates, contractors should be attentive to and address issues relating to the interpretation and application of the PRC during negotiations and prior to contract award or modifications. First, contractors should pay careful attention to the identification of the basis of award customer. A contractor can propose what it believes is the appropriate basis of award customer, but should be prepared to explain and justify its position. It is usually in the contractor’s interest to avoid overbroad definitions of its basis of award customer (e.g., “all

commercial accounts”). While the contracting officer may seek to designate the class of customer that receives the contractor’s best discounts as the basis of award customer, the contractor may not believe that that class of customer is the most appropriate one, and, if so, should be prepared to explain why (e.g., the customer accounts for a relatively small percentage of the contractor’s total sales, or the circumstances, terms and conditions under which sales are made to that class of customer are significantly different from purchases made by GSA contract users). Another way to limit the reach of the PRC is to attempt to negotiate lower MOTs.

Contractors should also disclose any facts, assumptions or interpretations relating to their commercial sales practices and/or to their compilation or submission of information regarding those practices that is relevant to the subsequent interpretation or application of the PRC. (For example, some contractors may have a standard commercial practice of allowing their commercial customers, including their basis of award customers, to buy at net prices equal to the GSA prices; in such cases, sales to the basis of award customer at prices down to the GSA price should not be treated as disturbing the relationship between the basis of award customer and the Government.) Likewise, a contractor should disclose any limitations in the capability of the IT or other data-processing system that will be used in monitoring, collecting and/or reporting data relating to PRC compliance.

Contract award documents issued by GSA typically included specific language relating to the PRC, e.g., identifying the basis of award class of customer and/or the price/discount relationships between that class of customer and the Government. Contractors should try to ensure that such documents reflect any significant understandings or assumptions relating to the interpretation and application of the PRC (for example, situations involving application of the PRC where the contractor has multiple MOTs, or situations that are clearly disclosed as

deviations and should be excluded from PRC consideration after award). See Xerox Corp., GSBCA No. 15190, 01-2 BCA ¶ 31528 (2001) (finding that parties specifically exempted trade-ins from the reach of the PRC); see also Gelco Space, GSBCA Nos. 7916, 7917, 91-1 BCA ¶ 23,387 (1990) (contract incorporated a clause defining how price reductions would be calculated).

B. Other Compliance Considerations

Any contractor that has or anticipates submitting a proposal for the award of a FSS contract should have appropriate personnel, policies, and procedures in place that are sufficient to give adequate assurance of compliance with applicable price-reduction requirements. While those personnel and/or policies and procedures must be tailored to the particular products, sales and marketing practices, and data-processing capabilities of the contractor, the following are illustrative of the types of personnel and/or procedures that should be in place as a prerequisite to MAS contracting:

- Order-entry procedures and controls, including mechanisms for monitoring commercial sales, and in particular, procedures for tracking and identifying sales of FSS contract items to “basis of award” customers or category of customer at prices (*i.e.*, inclusive of all discounts or other concessions) which could alter the relationship between the basis of award customer price and the MAS contract price for that item.
- Procedures to taking appropriate action, including rejection or suspension, pending higher-level approval of sales that disturb the relationship between the basis of award customer and GSA (*e.g.*, sales at a lower price or more favorable discounts or other concessions to basis of award customers than the MAS contract price for the same product).
- Procedures for reviewing sales with a dollar amount above the MOT to ensure that they comply with all requirements applicable to that exception to the PRC.
- Procedures for identifying and informing the contracting officer in a timely manner of situations presenting good-faith questions of interpretation and application of the PRC that arise in the course of contract performance and explaining how the contractor plans to treat

those situations. If applicable, such disclosures should be accompanied with an explanation regarding why the contractor believes the pricing does not qualify as a price reduction.

- Procedures for providing notification to the contracting officer of transactions that are subject to the PRC as soon as possible, and, in any event, no later than 15 days after the transaction creating the price reduction occurs or such other time as agreed to in the contract.
- Procedures for applying any price reduction to which the Government is entitled under the PRC to all Government orders of the affected product as of the date of the price reduction (including retroactively, if necessary).
- Procedures for identifying and notifying the Government of errors in quotation or billings.
- Procedures for notifying the contracting officer of all relevant promotions or temporary price reductions and offering the same terms to the Government through the expiration date.
- Procedures for retention of all records relating to price reductions to which the Government has a right of access under applicable laws, regulations, and/or contract clauses.

As the decision in Invacare, supra, teaches, be alert for the impact of later modifications on the reach of the PRC. For example, where the modification adds a new product, the modification should specifically identify the basis of award customer for the product and its pricing relationship with Government. In addition, note that while extending lower pricing or higher discounts than is provided in the GSA contract to customers outside the basis of award customer class will not trigger a price reduction under the PRC, those lower prices will have to be disclosed in connection with future proposal submissions and could impact negotiations regarding pricing or the definition of the basis of award customer class. Finally, any changes outside the basis of award class of customer should be considered before the company makes certain representations associated with modifications to add products or pass along price increases. In these cases, the contracting officer may ask the contractor to represent that its

commercial sales practices have not changed since it made its initial standard commercial sales practices disclosure with respect to the contract.”

PRC compliance is an important consideration for any GSA (or VA) FSS contractor. GSA regularly conducts post-award audits to ensure PRC compliance. See GSAR 552.215-7 (providing for such audits). If the GSA discovers violations of the PRC, it will demand retroactive, dollar-for-dollar refunds for all affected products/services, going back to the date(s) of the price reduction(s). In addition, when GSA demands PRC refunds, it may also demand multiple damages and penalties under the civil False Claims Act.

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