

January 28, 2005



Acquisition

Contract with Reliant Energy
Solutions East
(D-2005-027)

Department of Defense
Office of the Inspector General

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Acronyms

CFTC	Commodity Futures Trading Commission
DESC	Defense Energy Support Center
DLA	Defense Logistics Agency
FAR	Federal Acquisition Regulation
FERC	Federal Energy Regulatory Commission
RES	Reliant Energy Services, Inc.
RESE	Reliant Energy Solutions East
SDO	Suspension/Debarment Official
SEC	Securities and Exchange Commission
SSET	Source Selection Evaluation Team



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

January 28, 2005

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Report on Contract With Reliant Energy Solutions East (Report No. D-2005-027)

We are providing this report for review and comment. We conducted the audit in response to a conference report request accompanying the Department of Defense Appropriations Act for FY 2005. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Logistics Agency comments were partially responsive. We request additional comments on Recommendations 2. and 3. by March 30, 2005.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Audcm@dodig.osd.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Kimberley A. Caprio at (703) 604-9314 (DSN 664-9202) or Ms. Carol N. Gorman at (703) 604-9314 (DSN 664-9314). The team members are listed inside the back cover. See Appendix D for the report distribution.

Robert K. West

for Francis E. Reardon
Deputy Inspector General
for Auditing

Office of the Inspector General of the Department of Defense

Report No. D-2005-027

January 28, 2005

(Project No. D2004CB-0215)

Contract With Reliant Energy Solutions East

Executive Summary

Who Should Read This Report and Why? DoD contracting officials, program managers, and Military personnel involved in the contract award process for the supply of electricity to DoD.

Background. This audit was performed in response to a conference report request accompanying the Department of Defense Appropriations Act for FY 2005, which states:

... the Department of Defense issued a \$36 million contract to Reliant Energy Solutions East to provide electricity to military installations on May 19, 2004.* The Federal Acquisition Regulation authorizes the suspension of a contractor on the basis of adequate evidence of any offense “indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of the contractor.” The conferees direct the Department of Defense Inspector General to review the contract and take any necessary action against Reliant Energy, Inc., and its subsidiaries, if appropriate. The Department is directed to report to the Committees on Appropriations within 180 days of enactment of the Act on the finding of its review and any subsequent actions taken on the contract.

The Federal Acquisition Regulation Part 9, “Contractor Qualifications,” prescribes the policies and procedures governing the debarment and suspension of contractors and the responsibility determination for prospective contractors.

In May 2004, the Defense Energy Support Center, a field activity of the Defense Logistics Agency, awarded a \$47,694,368 contract to Reliant Energy Solutions East to supply retail electricity to multiple Federal Government installations. The Reliant Energy Solutions East proposal named an affiliate company, Reliant Energy Services, Inc., as the wholesale supplier for that electricity. Reliant Energy Services, Inc., was indicted on April 8, 2004, for the criminal manipulation of the California energy market in June 2000. Public Citizen, a national nonprofit public interest organization, questioned the DoD contract award to Reliant Energy Solutions East and called for debarment or suspension action.

Results. The Defense Energy Support Center electricity contract was awarded in compliance with the Federal Acquisition Regulation Part 9 criteria; however, improvements are needed in the responsibility determination process and the source selection scoring process.

*Original amount and date of contract award were \$11,776,119 and May 13, 2004. Modification P00001, increased the amount of award to \$47,694,368 on May 18, 2004.

- The contracting officer determined that Reliant Energy Solutions East was a responsible prospective contractor without considering all of the data in the proposal and without requesting a legal review concerning the Reliant Energy Services, Inc., indictment and its effect on Reliant Energy Solutions East.
- The contracting specialist made 182 input errors, an error rate of 15.3 percent, when posting technical scores to an automated summary spreadsheet for the 4 bidders to the Defense Energy Support Center electricity contract.

As a result, the Defense Logistics Agency was exposed to unnecessary contract risk, and the support for possible suspension action may have been affected.

The Inspector General of the Department of Defense is not a Suspension/Debarment Official and cannot take action against Reliant Energy, Inc., as requested in the conference report to the Department of Defense Appropriations Act for FY 2005. The Suspension/Debarment Official for the Defense Logistics Agency will determine whether suspension action should be taken against Reliant Energy, Inc., or its subsidiaries. As of the date of this report that determination had not been made and, on December 8, 2004, the Defense Energy Support Center awarded a new contract to Reliant Energy Solutions East with no objection from the Suspension/Debarment Official.

The Director, Defense Logistics Agency needs to establish guidance to require contracting officers to evaluate all requested data when making responsibility determinations, to report indictments of prospective contractors' affiliates, and to provide oversight of the source selection scoring process. In addition, the Director needs to establish a process to coordinate with other Federal agencies to determine whether criminal, civil, or regulatory action has been initiated against prospective energy contractors. The Director also needs to consider the information provided in this report before making a determination to proceed with suspension action against Reliant Energy, Inc., or any of its subsidiaries. See the Finding section for detailed recommendations.

Management Comments and Audit Response. The Director, Logistics Operations, Defense Logistics Agency concurred with the finding and recommendations. The Director agreed to establish guidance requiring contracting officers to evaluate all requested data when making responsibility determinations, to report indictments of prospective contractors' affiliates, and to provide oversight of the source selection scoring process. The Director stated the Defense Logistics Agency will continue to coordinate with the appropriate agencies to determine whether criminal, civil, or regulatory action has been initiated against prospective energy contractors. Lastly, the Director agreed to consider all relevant documentation, including this audit, before rendering suspension/debarment action against Reliant Energy Solutions East. A discussion of management comments is in the Finding section of the report and the complete text is in the Management Comments section.

The Defense Logistics Agency comments were partially responsive. We request that the Defense Logistics Agency provide specific information concerning the process used to coordinate with the regulatory agencies. In addition, we request clarification as to why the comments only referred to possible suspension/debarment action against Reliant Energy Solutions East and not the parent company, Reliant Energy, Inc., or the indicted subsidiary. We request that the Defense Logistics Agency provide additional comments in response to the final report, as indicated in the transmittal memorandum, by March 28, 2005.

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Background

This audit was performed in response to a conference report request accompanying the Department of Defense Appropriations Act for FY 2005, which states:

... the Department of Defense issued a \$36 million contract to Reliant Energy Solutions East to provide electricity to military installations on May 19, 2004.¹ The Federal Acquisition Regulation authorizes the suspension of a contractor on the basis of adequate evidence of any offense “indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of the contractor.” The conferees direct the Department of Defense Inspector General to review the contract and take any necessary action against Reliant Energy, Inc., and its subsidiaries, if appropriate. The Department is directed to report to the Committees on Appropriations within 180 days of enactment of the Act on the finding of its review and any subsequent actions taken on the contract.

The Federal Acquisition Regulation (FAR) language cited in the conference report is located in FAR 9.407-2, “Causes for Suspension,” which lists the causes for suspending a party from contracting with the Federal Government.

On April 8, 2004, the Department of Justice indicted Reliant Energy Services, Inc., (RES) an affiliate company of Reliant Energy Solutions East (RESE), for the criminal manipulation of the California energy market in June 2000. Public Citizen, a national nonprofit public interest organization, questioned the DoD contract award to RESE, stating that, “Reliant Energy is neither a responsible or ethical company,” and called for the debarment or suspension of Reliant Energy from all Federal contracts in letters to Senator Dianne Feinstein, the Secretary of Defense, and the Defense Logistics Agency (DLA). In requesting the debarment or suspension action, Public Citizen made no distinction between the parent company, Reliant Energy, Inc., and its subsidiaries.

Electricity Contract. The Defense Energy Support Center (DESC), a field activity of DLA, issued solicitation SP0600-03-R-0149 on October 2, 2003, for the supply and delivery of electricity to Federal Military and civilian facilities located in Maryland, New Jersey, and Virginia. The solicitation was issued as a “combined solicitation” which allowed the contracting officer to make multiple contract awards from the same solicitation. DESC received bids from four prospective contractors and awarded contracts to three of those four contractors. RESE was awarded one of the contracts, SP0600-04-D-8007, on May 13, 2004. The initial amount of the contract was \$11,776,119, and modification P00001, dated May 18, 2004, increased the contract award amount to \$47,694,368. The contract was a firm-fixed-price contract to supply retail electricity to Adelphi Labs; Andrews Air Force Base; the National Institute for Science and Technology; Navy Carderdock; Naval Medical Center, Bethesda; and Walter

¹Original amount and date of contract award were \$11,776,119 and May 13, 2004. Modification P00001, increased the amount of award to \$47,694,368 on May 18, 2004.

Reed Army Medical Center. The contract period of performance was for the 17 months beginning July 2004, with no option period. The proposal submitted by RESE named RES as the wholesale supplier for the electricity to be supplied for the contract.

Reliant Energy, Inc. Reliant Energy, Inc.,² headquartered in Houston, Texas, is an energy producer and marketer in the United States. The company provides and sells electricity in the retail and wholesale markets and operates plants that generate electricity. Reliant Energy, Inc., consists of two principal business segments: a retail segment, which includes RESE, and a wholesale segment, which includes RES. See the Reliant Energy, Inc., organization chart in Appendix B.

- RESE is a limited liability corporation and a wholly-owned subsidiary of Reliant Energy, Inc. It was formed February 4, 2002, and provides electricity to retail customers primarily in Texas, Maryland, and New Jersey. As a part of the Reliant Energy, Inc., retail energy segment, RESE operates in states that have deregulated retail electricity sales.
- RES is a wholly-owned subsidiary of Reliant Energy, Inc. It was formed February 2, 1999, and provides electricity for the United States wholesale market. As a part of the Reliant Energy, Inc., wholesale business segment, RES operates electric generation facilities and sells electricity based on market pricing, which may include buying and selling electricity on the commodity exchanges.

The retail segment is subject to individual state regulation and oversight. The wholesale segment is subject to regulation and oversight from the Federal Energy Regulatory Commission (FERC) and the Commodity Futures Trading Commission (CFTC), because the wholesale segment participates in the commodities market.

RES Indictment and Regulatory Settlements. The Department of Justice indicted RES and four of its officers on April 8, 2004, for the criminal manipulation of the California energy market in June 2000. The indictment charged that RES intentionally drove up the price of electricity in California by shutting off certain of the company's power generation plants to create the appearance of an electricity shortage and disseminating false information to the market that wrongly attributed the shut-downs to environmental limitations. The specific charges included conspiracy to commit wire fraud and commodities manipulation, in violation of section 371, title 18, United States Code, (18 U.S.C. 371); wire fraud, in violation of 18 U.S.C. 1343; commodities manipulation, in violation of 7 U.S.C. 13(a)(2); and aiding and abetting, in violation of 18 U.S.C. 2.

From January 2003 to March 2004, Reliant Energy, Inc., and RES agreed to pay up to \$82.6 million to settle claims with regulators from CFTC and FERC. Those claims resulted from allegations that RES manipulated the energy market. In May 2003, Reliant Energy, Inc., accepted an order from the Securities and

²Before April 26, 2004, Reliant Energy, Inc. was known as Reliant Resources, Inc.

Exchange Commission (SEC) to cease and desist from engaging in round-trip trades³ and erroneously moving earnings from one accounting period to another that resulted in the misstatement of its trading volumes, revenues, and expenses. See Appendix C for a timeline of critical events including the regulatory actions, the indictment, and the contract award process.

Acquisition Regulation. FAR Part 9, “Contractor Qualifications,” prescribes the policies, standards, and procedures pertaining to the responsibility determination for prospective contractors, and the policies and procedures governing the debarment and suspension of contractors.

Objectives

The audit objective was to determine the appropriateness of awarding a contract to RESE and subsequent DoD actions. See Appendix A for a discussion of the scope and methodology related to the objective.

³Round-trip trades are actions that attempt to inflate transaction volumes through the frequent purchase and sale of a particular commodity. In the energy sector, power is sold and then quickly bought back from the same customer at the same price, which falsely increases a company’s market position and can make the demand for power appear greater than it is in reality and thus force prices up.

Contract With Reliant Energy Solutions East

The DESC electricity contract was awarded in compliance with FAR Part 9 criteria; however, improvements are needed in the responsibility determination process and the source selection scoring process.

- The contracting officer who awarded the DESC contract determined that RESE was a responsible prospective contractor without considering all of the data available in the proposal and without requesting a legal review concerning the RES indictment and its effect on RESE.
- The contracting specialist made 182 input errors, an error rate of 15.3 percent, when transferring the 1,188 entries from the technical evaluation scoring sheets to an automated summary spreadsheet for the 4 bidders to the DESC electricity contract.

DLA guidance does not clearly define the contracting officer's responsibility to review requested proposal data, to report indictments or other actions taken against an affiliate of a prospective contractor to the General Counsel, or to provide oversight for the source selection scoring process. In addition, DLA had no mechanism to identify when indictments or regulatory actions are taken by other Federal agencies against current or prospective contractors in the energy sector. As a result, DLA was exposed to unnecessary contract risk and the support for possible suspension action may have been affected.

Criteria

FAR Subpart 9.1, "Responsible Prospective Contractors," prescribes the policies, standards, and procedures for determining whether prospective contractors and subcontractors are responsible. According to the FAR, the determination of responsibility is based on a prospective contractor's ability to meet certain general standards prescribed in the FAR and, if applicable, special standards as prescribed in the request for proposal.

General Standards. To meet the FAR general standards for responsibility, the prospective contractor must provide evidence of the seven following items:

- adequate financial resources;
- the ability to comply with the contract delivery schedule;
- a satisfactory performance record;
- a satisfactory record of integrity and business ethics;

-
- the necessary organization, experience, and accounting system support to manage the contract;
 - the necessary equipment and facilities to perform the contract; and
 - be otherwise qualified and eligible to receive the award under applicable laws and regulations.

Special Standards. In addition to the general standards, the DESC contracting officer included special standards in the request for proposal. To meet the special standards the prospective contractor must provide evidence of the following four items:

- 6 months minimum experience providing electricity to retail customers,
- licenses to market electricity in the State,
- documented ability to obtain transmission service agreements in the company's name for the points of receipt, and
- evidence of responsibility in accordance with the general standards in FAR Subpart 9.1.

To make the final determination of responsibility, FAR 9.405(d)(4) states that the contracting officer shall determine whether the contractor is on the excluded parties listing system. The excluded parties listing system is maintained and distributed by the General Services Administration and contains the names, addresses, and identity of parties debarred, suspended, or voluntarily excluded from Federal contracts. The FAR states that contractors and subcontractors debarred, proposed for debarment, or suspended are excluded from receiving contracts, and agencies shall not solicit offers from, award contracts to, or consent to subcontracts with these contractors. When the contracting officer signs the contract, that action constitutes a determination of responsibility by the contracting officer.

The DESC electricity contract was awarded in compliance with FAR Part 9 criteria; however, improvements are needed in the responsibility determination process and the source selection scoring process.

Determination of Responsibility

The contracting officer who awarded the DESC contract determined that RESE was a responsible prospective contractor without considering all of the data available in the proposal and without requesting a legal review concerning the RES indictment and its effect on RESE. The DESC contracting officer made his initial responsibility determination in January 2004, learned of the RES indictment on April 12, 2004, and signed the final determination of RESE responsibility on June 15, 2004.

Initial Determination of Responsibility. The DESC contracting officer made his initial determination of contractor responsibility in January 2004, during the review of technical proposals. According to documents in the contract file, the contracting officer was ultimately responsible for making the responsibility determination, which was based on a review of the contractor's proposal. In accordance with the request for proposal, RESE provided the contracting officer with access to its most recent annual report and filing to the SEC (10K filing), a description of its management practices and key personnel resumes, a copy of its state marketing licenses, a description of its electricity supply sources, and a record of its past performance.

Consistent with FAR Subpart 9.1, the DESC contracting officer determined whether RESE was fiscally responsible and could deliver electricity for the length of the contract period. The primary documents used by the contracting officer to support the determination were the state marketing licenses. RESE provided a copy of its Maryland license, issued on May 21, 2003, and its New Jersey license, issued on March 5, 2003, in its proposal. The contracting officer considered the state marketing licenses to be excellent support for the seven items required to meet the general standards and the four items required to meet the special standards because of the stringent licensing requirements for electricity suppliers. For example, the State of Maryland requires suppliers to provide organizational data, its operational capacity and scope of operations, financial information, affidavits of tax compliance, and verification of financial and other data before it will grant a license to conduct business in the state.

In addition to the review of licensing documents, the contracting officer stated that he reviewed the following sections of the RESE proposal to provide additional support for the general and special standards.

- Resumes of key personnel were reviewed to confirm that RESE personnel had experience in the electric power supply industry.
- Past performance documents were reviewed to ensure that RESE had provided adequate service to current and former customers.
- Sources of working capital were reviewed to determine whether RESE had adequate working capital. The majority of the RESE submission contained financial data for Reliant Energy, Inc., its parent company. The contracting officer stated that subsidiaries typically include financial data from the parent since the parent companies have a more diverse portfolio and a stronger financial position.
- The risk management program was reviewed to determine whether RESE had supply backup plans to protect itself from market price fluctuations. The RESE proposal stated that it would purchase 100 percent of its wholesale electricity supply for the DESC contract from RES. The contracting officer stated that he considered this a positive factor because the proposal also stated that RES had the ability to generate its own electricity if it could not purchase enough from the marketplace to support any possible RESE needs.

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- The FAR 52-209.5, “Certification Regarding Debarment, Suspension, Proposed Debarment, and Other Responsibility Matters,” was reviewed to ensure that the company certified that it was not presently debarred, suspended, proposed for debarment, or declared ineligible for the award of contracts by a Federal agency.

The contracting officer stated that he did not review the RESE annual report or 10K filing in his determination of the company’s responsibility. He stated that the annual report and the 10K filing were requested only to provide assurance that the electricity suppliers were serious about bidding for the contract and had the business acumen to perform the contract. As stated previously, the contracting officer primarily relied on the state marketing licenses to provide support for the responsibility determination. We agree that the state marketing licenses provide support for that determination; however, the contracting officer should have also reviewed the annual report and the 10K filing. The annual report and 10K filing should include a contingency section that includes probable and reasonably estimated liabilities based on regulatory fines, penalties, or indictments. Review of the RESE annual report and 10K filing showed the payments to the regulatory agencies and the possibility of a Department of Justice indictment. Although the contracting officer learned of the regulatory fines and the indictment by other means, he should have reviewed the annual reports and 10K filing to determine whether any contingencies occurred after the state marketing licenses were granted, which would not have been considered by the state licensing board, but may affect a prospective contractor’s responsibility.

The contracting officer stated that based on his review of the RESE proposal and the results of the technical evaluation, he made an initial determination that RESE was a responsible prospective contractor.

Response to Indictment. The DESC contracting officer learned of the RES indictment on April 12, 2004, one month before the contract award. He received no formal notification of the indictment, but instead learned of it from reading a trade publication. He stated that he considered whether the indictment had an effect on the present responsibility of RESE and its ability to supply electricity under the terms of the contract, and determined that it did not. He stated that he considered the following to make the determination:

- RESE was the offeror for the contract and neither RESE or its officers were included in the indictment.
- The parent company, Reliant Energy, Inc., was not included in the indictment. The contracting officer stated that his actions might have been different had the parent company or any of its officers been included in the indictment.
- RESE was a retail provider of electricity and did not participate in the wholesale or futures trading operations as did RES at the time of the charges. In addition, as a retail provider not participating in commodities trading, RESE was not subject to CFTC or FERC regulations.

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- RESE was not in existence in 2000 when the actions that led to the indictment took place.

The contracting officer did not consider as a factor that RESE would be purchasing its wholesale supply of electricity from RES and that financial penalties as a result of the indictment could adversely impact RES operations. Although the RESE proposal stated that it would receive 100 percent of its wholesale supply from RES for the DESC contract, the contracting officer stated that he was not required to consider that as a factor because the DESC contract was awarded under FAR Part 12, "Acquisition of Commercial Items." FAR Part 12 does not require a prospective contractor to name its ultimate supply source nor does it require that the contracting officer consider that ultimate source. Therefore, the contracting officer determined that, although RES was named as the wholesale supplier of electricity for RESE, that information had no bearing on the ability of RESE to comply with the terms of the contract. Further, he determined that the indictment of RES did not warrant notification or involvement of DESC Counsel. The contracting officer stated that he had enough information concerning the RES indictment to make the determination that it did not affect RESE responsibility and additionally, he did not want to burden DESC Counsel with the case.

Final Determination of Responsibility. The contracting officer made a final determination of the responsibility of RESE during the review of the contractor price proposals. Because of the volatility of electricity prices, the price proposals were not due or reviewed until 48 hours prior to contract award. FAR Subpart 9.405(d)(4) requires the contracting officer to check the excluded parties listing system immediately prior to contract award. That check was made on May 12, 2004, one day before the original contract award. We confirmed that the contract file included a printout from the excluded parties listing system, which stated as of May 12, 2004, no records were found concerning RESE. Although, because of administrative backlogs, the contracting officer did not sign the responsibility certification until June 15, 2004, we consider the printout to satisfy the FAR requirement.

The contracting officer stated that he was aware of the CFTC, FERC, and SEC actions against RES when making the final determination of RESE responsibility. He did not contact those agencies to gather additional information concerning the regulatory actions because RESE was not named as a party to the actions. Furthermore, the Assistant Counsel, DESC stated that even if RESE had been named in the action, the FAR does not state that regulatory actions or fines have an adverse effect on contractor responsibility.

Adequacy of the Contractor Officer's Decision. We consider the contracting officer to have met the FAR Part 9 requirements when he determined that RESE was a responsible prospective contractor. However, the contracting officer should have reviewed the contingency section of the annual report and the 10K filing to ensure that no additional liabilities had accrued since the state marketing licenses were issued. In addition, in learning of the RES indictment, the contracting officer should have informed the DESC Counsel of the indictment and requested a legal review. DESC Counsel had more expertise to determine whether the indictment would have an impact on the ability of RESE to perform under the

contract terms and whether suspension or debarment action should be initiated against Reliant Energy, Inc., or any of its subsidiaries.

Scoring for the Source Selection Process

The contracting specialist made 182 input errors, an error rate of 15.3 percent, when transferring the 1,188 entries from the technical evaluation scoring sheets to an automated summary spreadsheet for the 4 bidders to the DESC electricity contract. The technical evaluation scoring sheets were prepared by a three-member source selection evaluation team (SSET).

The SSET reviewed the technical proposals for the four contractors that bid on the DESC electricity contract, solicitation SP0600-03-R-0149, to determine the ability of those contractors to technically perform the contract. The technical SSET members assigned numerical scores in the categories of technical capability and industry experience. The technical SSET members entered raw scores onto scoring sheets and the DESC contracting specialist transferred those raw scores to an automated summary spreadsheet. The spreadsheet was designed to add and average the raw scores. The average scores were then transferred to another spreadsheet that also contained scores for the past performance and socioeconomic categories, which were scored by a separate SSET. In accordance with the source selection plan, weighting factors were assigned to each category score and an overall numeric rating was computed for each prospective contractor. That numeric rating was then converted to an adjectival score of Excellent, Very Good, Satisfactory, or Unsatisfactory. The source selection plan stated that the contract award would be made based on the adjectival score and price; a trade-off analysis would be necessary only if one or more of the prospective contractors had different adjectival scores. Based on the spreadsheet results, each of the four prospective contractors received a score of Very Good.

Of the 1,188 raw scores assigned by the technical SSET, we identified 182 errors made by the contracting specialist when transferring those scores to the summary spreadsheet, an error rate of 15.3 percent. We recomputed the numeric rating for the four contractors based on a corrected summary spreadsheet. That computation indicated that three of the four original numerical ratings were incorrect; however, the adjectival score for the three contractors remained in the Very Good range. Although the errors did not affect the overall adjectival scores for this specific source selection, the possibility exists that similar errors in other source selections could result in incorrect technical scores.

The contracting officer should ensure that adequate oversight is provided during the source selection process to ensure that raw scores are correctly transitioned between the scoring sheets and the summary spreadsheet. Although the errors in this case did not lead to an improper award, the possibility exists that an incorrect technical score could result in an improper contract award in the future.

DLA Guidance

DLA guidance does not clearly define the contracting officer's responsibility to review requested proposal data, to report indictments or other actions taken against an affiliate of a prospective contractor to the General Counsel, or to provide oversight for the source selection scoring process.

Responsibility Determination. As a supplement to FAR Subpart 9.1, DLA Directive 4105.1, "Defense Logistics Acquisition Directive," May 11, 2000, lists the requirements to determine whether prospective contractors are responsible. Because the contracting officer relied primarily on a state marketing license review to make a responsibility determination for the energy sector contractors, DLA guidance should require a review of the contingency section of the annual reports and 10K filing, which should list any fines, penalties, or criminal or civil actions that accrued after the state license was granted.

Debarment and Suspension. As a supplement to FAR Subpart 9.4, DLA Directive 4105.1 contains DLA specific debarment and suspension procedures. Contracting officers, upon learning of a contractor indictment, are required to submit a report to the DLA General Counsel recommending suspension of that contractor. The submission should be made within 2 weeks of the date of the indictment or the date that the contracting officer learned of the indictment. The Directive states that any DLA activity that is aware of the recommendation for suspension will coordinate with the General Counsel before taking any action, to include the award of a contract or purchase order to that contractor. The contracting officer must also determine whether the activity has current or has had past contractual relationships with the contractor or its affiliates, and, if so, whether the Government may have any basis for recovery of damages from, or other claims against, the contractor. However, the Directive does not state that the contracting officer should report the indictment of an affiliate or parent company of a prospective or current contractor, which depending on the severity of the charges and the affiliate relationship, could affect the responsibility of a prospective contractor. Because the responsibility of an affiliate could be affected, the contracting officer should be required to report, in a timely manner, indictments or other criminal or civil charges filed against a prospective contractor's affiliate to the General Counsel.

Scoring for the Source Selection Process. DLA lacks guidance that addresses the contracting officer's responsibility to oversee the source selection scoring process. To ensure that errors in scoring are discovered and corrected, the contracting officer should be required to provide oversight for the work performed by the contracting specialists. The contracting officer is ultimately responsible for the contract award and because of that responsibility, the contracting officer should ensure that the work performed by the contracting specialist is correct. Proper oversight would increase the confidence that the source selection process, as a whole, is effective and results in accurate technical scores and proper contract awards.

Notification of Indictments and Regulatory Actions

DLA had no mechanism to identify when indictments or regulatory actions were taken by other Federal agencies against current or prospective contractors in the energy sector. The contracting office and its personnel currently depend on trade publications for that type of information. Because the CFTC, the Department of Justice, the FERC, and the SEC typically do not coordinate their investigative or enforcement actions with other Federal agencies, DLA should consider establishing a point of contact within those organizations. The contracting officer can then inquire about any investigative or enforcement actions of prospective contractors within the energy sector and whether those actions could affect the responsibility determination. If warranted, the contracting officer can then report those actions to the appropriate counsel.

An update to the DLA Directive 4105.1 or the establishment of separate guidance, along with a mechanism to obtain information from the Department of Justice and the regulatory agencies, should enable the contracting officer to better support a responsibility determination and ensure that contracts are awarded appropriately. In addition, it will improve communication of potential suspension and debarment actions to the General Counsel.

Contract Risk and Suspension Action

DLA was exposed to unnecessary contract risk and the support for possible suspension action may have been affected.

Contract Risk. The RES indictment and the errors in the scoring for the source selection process increased the contract risk for the DESC electricity contract. Because RES was named as the sole wholesale supplier for RESE, if RES had been impacted financially by the indictment, or the cumulative effect of the regulatory fines plus the indictment, RESE could have had problems fulfilling its contractual obligations. The contracting officer should have recognized that possibility, and by reporting the issue to the DESC Counsel and requesting a legal review, could have better mitigated the performance risk, and strengthened his support for the award to RESE. In addition, an error rate of 15.3 percent in the scoring for the source selection process does not provide reasonable assurance that a contract will be awarded to the appropriate bidder.

Suspension Action. The contracting officer, by declaring RESE a responsible contractor, may have affected the support for possible suspension action, if warranted. Reliant Energy, Inc., stated, in an August 20, 2004, submission to the Air Force, that the company should not be considered for suspension because the DESC contracting officer awarded RESE a contract, knowing that RES was under indictment. Reliant Energy, Inc., asserted that DESC made an “affirmative determination of responsibility of the offering entity and possibly its affiliates,” and that DLA supported that determination. The submission also cited a Board of Contract Appeals case, *Lion Raisins, Inc., versus United States*, 51 Federal Claims 238 (2001), in which a suspension action was overturned because the

Department of Agriculture was aware of contractor misconduct but subsequently found the contractor responsible by awarding it several interim contracts. Had the DESC Counsel been informed of the indictment prior to the contract award, she could have determined whether or not the contract award to RESE would be an endorsement of RES responsibility.

Ongoing DoD Actions

In addition to the review of the electricity contract, the conference report requested that the Inspector General of the Department of Defense take any necessary action against Reliant Energy, Inc., and its subsidiaries, if appropriate. The conference report cited language from FAR Subpart 9.407-2 that lists the causes for suspending a party from contracting with the Federal Government. However, the Inspector General of the Department of Defense is not an authorized Suspension/Debarment Official (SDO). Typically, the SDO is appointed from the agency with the predominant financial interest in the contract. The Department of Veterans Affairs and the Department of the Air Force had the largest financial interest in contracts with RESE, and DLA deferred the case to the Air Force on July 13, 2004, 96 days after the indictment. The Air Force SDO issued a show cause letter⁴ to Reliant Energy, Inc., on August 6, 2004, and received a response on August 20, 2004. Before the Air Force SDO could take additional steps in the process, he was required to recuse himself from the case. The suspension/debarment action was then accepted by the DLA SDO on August 31, 2004, who, as of the date of this report, had not made a determination to proceed with suspension action.

FAR Subpart 9.4 focuses on three primary categories for which a contractor can be excluded from receiving Federal Government contracts: debarment, proposed for debarment, and suspension. A contractor may be debarred if convicted or civilly charged for fraud in obtaining a public contract or subcontract, violation of antitrust statutes, or commission of other offenses indicating a lack of business integrity or honesty. A contractor is considered “proposed for debarment” when an SDO advises a contractor that it is being considered for debarment. The contractor remains in a proposed for debarment status until the SDO makes a determination whether to impose or not impose debarment. A contractor may be suspended if “suspected of” committing any of the offenses that are cause for debarment, to include being indicted.

FAR Subpart 9.4 states that the existence of a cause for suspension does not necessarily require that a contractor be suspended. The SDO should consider the seriousness of the act and may, but is not required to, consider any remedial measures taken by the contractor subsequent to the act. However, the contractor has the burden of demonstrating, to the satisfaction of the debarring official, its present responsibility. Accordingly, Reliant Energy, Inc., submitted to the Air Force SDO a list of actions taken to ensure that the type of conduct that led to the

⁴A show cause letter is issued to a contractor when the SDO discovers inappropriate or controversial conduct on the part of a Federal Government contractor. The letter requests that the contractor present information to support its responsibility.

indictment can no longer occur. Reliant Energy, Inc., stated that since 2000, when the alleged illegal conduct took place, the following actions have been taken:

- replacement of the Chief Executive Officer of Reliant Energy, Inc., and all of the officers of RES;
- development and implementation of a code of conduct;
- cooperation with the regulatory agencies and the Department of Justice;
- issuance of the corporate Business Ethics Policy; and
- establishment of the positions of Corporate Compliance Officer and a Compliance Director for Trading, who sit on the trading floor and provide guidance and advice to the traders.

Reliant Energy, Inc., also counseled the four employees named in the indictment, two of whom are no longer employed by Reliant Energy, Inc., or any of its subsidiaries, and two of whom are on administrative leave awaiting the resolution of the indictment.

The DLA SDO must consider the relevant facts of the RES indictment and the information provided in this report before making a determination to proceed with suspension action against Reliant Energy, Inc., or any of its subsidiaries. However, that determination should be expedited because DESC has continued to award contracts to RESE with that suspension action still outstanding. According to an Assistant Counsel, DESC, a contract was awarded to RESE on December 8, 2004, for an estimated value of \$6.5 million. The Assistant Counsel stated that the contracting officer determined RESE to be a responsible prospective contractor and that the determination was reviewed by DESC and DLA and that the DLA SDO had no objection to the award. Resolution of the suspension action will ensure that contracting officers and counsel can make a timely and informed decision as to the responsibility of Reliant Energy, Inc. and its subsidiaries.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Logistics Agency do the following:

1. Update DLA Directive 4105.1, "Defense Logistics Acquisition Directive," May 11, 2000, or establish guidance to require contracting officers to:

a. Evaluate the annual reports and Securities and Exchange Commission filings for prospective energy contractors to determine whether contingent liabilities exist that may affect the responsibility determination.

b. Report indictments, convictions, or other criminal or civil actions filed against a prospective contractor's known subcontractor or affiliate to the appropriate Suspension/Debarment Official to ensure that the action has no adverse effect on the responsibility of the prospective contractor and that timely suspension/debarment action is taken, if warranted.

c. Provide oversight of the scoring for the source selection process to reduce the potential for errors.

Defense Logistics Agency Comments. The Director, Logistics Operations, Defense Logistics Agency concurred and stated that appropriate guidance would be established.

2. Establish a process to coordinate with applicable regulatory agencies and the Department of Justice prior to awards of energy contracts to determine whether criminal, civil, or regulatory action has been initiated against prospective energy contractors.

Defense Logistics Agency Comments. The Director, Logistics Operations, Defense Logistics Agency concurred and stated that the Defense Logistics Agency will rely on the Federal Acquisition Regulation Part 9 procedures and continue to coordinate with the applicable regulatory agencies and the Department of Justice through the Defense Criminal Investigative Service.

Audit Response. The Defense Logistics Agency comments were partially responsive. Although the Director, Logistics Operations concurred with the recommendation, he did not provide information concerning the specific process used to coordinate with the regulatory agencies. We request additional comments that provide a description of the specific method used to coordinate and obtain information from the regulatory agencies prior to contract award, to determine whether regulatory action has been initiated against prospective energy contractors.

3. Consider the information provided in this report before making a determination to proceed with suspension action against Reliant Energy, Inc., or any of its subsidiaries.

Defense Logistics Agency Comments. The Director, Logistics Operations, Defense Logistics Agency concurred and stated that the Suspension/Debarment Official will consider all relevant documentation, to include this report, before rendering a suspension/debarment decision regarding Reliant Energy Solutions East.

Audit Response. The Defense Logistics Agency comments were partially responsive. The intent of the recommendation was to ensure that all relevant documentation was reviewed before Reliant Energy, Inc. or any of its subsidiaries were considered for suspension/debarment action. We request clarification as to why the Director, Logistics Operations only referred to suspension/debarment action of Reliant Energy Solutions East and not the parent company Reliant Energy, Inc. or the indicted subsidiary.

Appendix A. Scope and Methodology

We reviewed the procedures and documentation used to support the DESC contract award to RESE. We collected, reviewed, and analyzed documents dated from May 2000 through December 2004. Specifically, we evaluated the FAR, DLA guidance, pre-award and post-award contract documentation, orders issued from the regulatory agencies, and the Department of Justice indictment. In addition, we reviewed organization charts, legal opinions, e-mail correspondence, and Public Citizen press releases.

We interviewed DLA, DESC, and Defense Contract Audit Agency personnel to obtain a better understanding of the energy sector and the contract award process. Additionally, we also interviewed FERC, CFTC, and SEC personnel to evaluate the regulatory environment within the energy industry and specific enforcement actions taken against energy companies. We also interviewed Reliant Energy, Inc., and RESE senior management and general counsel to obtain background information on the organizational structure of the company and its subsidiaries and to obtain additional information concerning the energy industry. Furthermore, we interviewed personnel from the Northern District of California U.S. Attorneys Office to obtain a better understanding of the RES indictment and the actions that led to that indictment.

We performed this audit from August 2004 through November 2004 in accordance with generally accepted government auditing standards.

We did not review the management control program because the audit scope was limited to the specific issue identified in the conference report request in the Department of Defense Appropriations Act for FY 2005.

Use of Computer-Processed Data. We did not use computer-processed data to perform this audit.

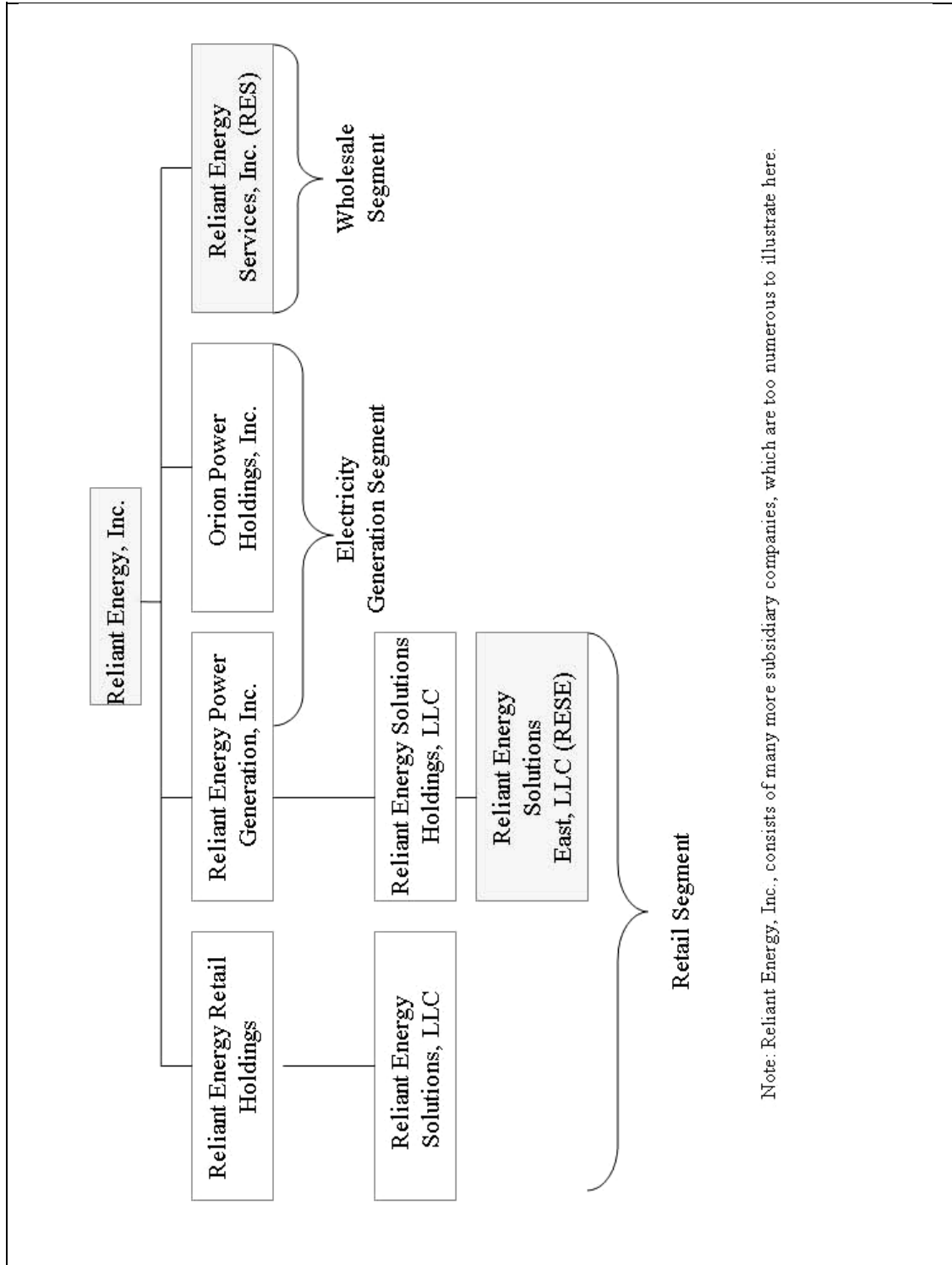
Use of Technical Assistance. We obtained assistance from an Associate Deputy General Counsel from the Office of General Counsel of the Office of the Inspector General of the Department of Defense. The Associate Deputy General Counsel assisted the audit team in determining whether the DESC contracting officer complied with FAR Part 9 and conducted proper due diligence in making his responsibility determination.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the DoD Contract Management high-risk area.

Prior Coverage

No prior coverage has been conducted on the award of retail electricity contracts during the last 5 years.

Appendix B. Reliant Energy, Inc., Organization Chart



Appendix C. Timeline of Critical Events

The timeline provides a sequential listing of the actions taken against RES concerning allegations that it manipulated the California energy market and conducted round-trip trading. In addition, the RESE contract award and subsequent DoD actions are shown to provide an overall perspective of the critical events associated with the contract award.

- January 31, 2003: RES settled with FERC on allegations that it limited the amount of power offered to the California Power Exchange in June 2000. Case settled for \$13.8 million.
- May 12, 2003: Reliant Energy, Inc., and RES accepted an order from the SEC to cease and desist from engaging in round-trip trading and moving earnings from one accounting period to another.
- October 2, 2003: DESC issued solicitation SP0600-03-R-0149 for the supply and delivery of electricity to Federal Military and civilian facilities located in Maryland, New Jersey, and Virginia.
- October 2, 2003: RES settled with FERC on allegations of manipulative bidding practices in the California energy market. Case settled for an amount not to exceed \$50 million.
- November 12, 2003: RESE submitted a proposal in response to DESC solicitation SP0600-03-R-0149.
- November 25, 2003: RES settled with the CFTC on allegations of false reporting, attempted manipulation of natural gas prices, and engaging in wash sales (round-trip trades). Case settled for \$18 million.
- March 4, 2004: RES settled with FERC on additional allegations that the company manipulated the California energy market. Case settled for \$836,000.
- April 8, 2004: Department of Justice indicted RES and four of its officers on allegations that it criminally manipulated the California energy market.
- April 12, 2004: DESC contracting officer learned of the RES indictment from a trade publication.
- May 13, 2004: DESC awarded contract SP0600-04-D-8007 to RESE to provide the supply of retail electricity to various Federal installations. Contract amount was \$47,694,368 million after modification P00001, dated May 18, 2004.
- June 15, 2004: DESC contracting officer signed the final determination of RESE responsibility.

-
- July 13, 2004: DLA deferred SDO responsibility for the RES case to the Air Force Deputy General Counsel for Contractor Responsibility.
 - August 31, 2004: The DLA Special Assistant for Contractor Integrity was named the SDO for the RES case because the Air Force Deputy General Counsel for Contractor Responsibility had sufficient reason to recuse himself from the case.
 - December 8, 2004: DESC awarded an estimated \$6.5 million contract to RESE to provide the supply of retail electricity to various Federal installations.
 - January 2005: DLA SDO conducting evaluation as to whether Reliant Energy, Inc., or its subsidiaries should be suspended from contracting with the Federal Government.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Director, Program Analysis and Evaluation
Director, Defense Procurement and Acquisition Policy

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Combatant Command

Inspector General, U.S. Joint Forces Command

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Information Systems Agency
Director, Defense Logistics Agency
Director, Defense Energy Support Center

Non-Defense Federal Organizations

Inspector General, Department of Justice
Inspector General, Commodity Futures Trading Commission
Inspector General, Securities and Exchange Commission
Office of the Executive Director, Federal Energy Regulatory Commission

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FORT BELVOIR, VIRGINIA 22060-6221

IN REPLY
REFER TO

DEC 22 2004

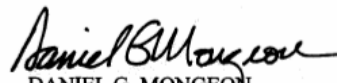
J-33

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: Draft of a Proposed Audit Report – Contract with Reliant Energy Solutions East
(Project No. D2004CB-0215) dated December 7, 2004

The objective of the subject draft Department of Defense Inspector General (DoDIG) report was to determine the appropriateness of awarding a contract to Reliant Energy Solutions East (RESE) and subsequent DOD actions. The contract was awarded by the Defense Energy Support Center, a field activity of the Defense Logistics Agency (DLA). The DoDIG audit report was undertaken in response to a conference report request accompanying the National Defense Appropriations Act for Fiscal Year 2005.

DLA appreciates the opportunity to comment on the draft report. DLA concurs with the DoDIG findings and will take immediate action to enact the recommendations. The point of contact for this response is Major Gary Binder, Supplier Operations Branch, Acquisition Division (J-3312), (703)-767-1364, or Ms. Emilia Snider, Defense Energy Support Center, Internal Review Office, (703)-767-9671.


DANIEL G. MONGEON
Major General, USA
Director, Logistics Operations

Attachment
DLA Comments

Federal Recycling Program



Printed on Recycled Paper

Subject: Contract With Reliant Energy Solutions East, December 7, 2004, Project No. D2004CB-0215

Finding: The Defense Energy Support Center (DESC) electricity contract was awarded in compliance with Federal Acquisition Regulation (FAR) Part 9 criteria; however, improvements are needed in the responsibility determination process and the source selection scoring process.

- *"The contracting officer who awarded the DESC contract determined that Reliant Energy Solutions East (RESE) was a responsible prospective contractor without considering all of the data available in the proposal and without requesting a legal review concerning the Reliant Energy Solution (RES) indictment and its affect on RESE.*

- *The contracting specialist made 182 input errors, an error rate of 15.3 percent, when transferring the 1,188 entries from the technical evaluation scoring sheets to an automated summary spreadsheet for the four bidders to the Defense Energy Support Center electricity contract.*

... As a result, Defense Logistics Agency (DLA) was exposed to unnecessary contract risk and the support for the suspension action may have been affected."

DLA Comments: DLA concurs with DoDIG finding that the contract was awarded in compliance with FAR Part 9 criteria.

Recommendations: DoDIG recommends that the Director, DLA:

1.a: Update the DLA Directive 4105.1 or establish guidance to require contracting officers to evaluate the annual reports and Securities and Exchange Commission (SEC) filings for prospective energy contractors to determine whether contingent liabilities exist that may effect the responsibility determination.

DLA Comments: CONCUR. DLA will establish appropriate guidance

1.b: Update the DLA Directive 4105.1 or establish guidance to require contracting officers to report indictments, convictions or other criminal or civil actions filed against a prospective contractor's known subcontractor or affiliate to the appropriate Suspension/Debarment Official to ensure that the action has no adverse effect on the responsibility of the prospective contractor and that timely suspension/debarment action is taken, if warranted.

DLA Comments: CONCUR. DLA will establish appropriate guidance.

Subject: Contract With Reliant Energy Solutions East, December 7, 2004, Project No. D2004CB-0215

1.c: Update the DLA Directive 4105.1 or establish guidance to require contracting officers to provide oversight of the scoring for the source selection process to reduce the potential for errors.

DLA Comments: CONCUR. DLA will establish appropriate guidance addressing the source selection process.

2: Establish a process to coordinate with applicable regulatory agencies and the Department of Justice prior to awards of energy contracts to determine whether criminal, civil, or regulatory action has been initiated against prospective energy contractors.

DLA Comments: CONCUR. DLA will rely on the procedures and process established in FAR Part 9. Additionally, DLA will continue to coordinate with applicable regulatory agencies and the Department of Justice through the Defense Criminal Investigative Service (DCIS).

3: Consider the information provided in this report before making a determination to proceed with the suspension action against Reliant Energy, Inc., or any of its subsidiaries.

DLA Comments: CONCUR. The DLA suspension/debarment official will consider all relevant documentation, including this audit, before rendering any suspension/debarment decision regarding Reliant Energy Solutions East.

Team Members

The Office of the Deputy Inspector General for Auditing of the Department of Defense, Contract Management prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

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