



AMERICAN COUNCIL OF ENGINEERING COMPANIES  
of South Carolina

October 8, 2019

Chief Procurement Officer  
J. Darrin Player  
SCDOT  
PO Box 191  
Columbia, SC 29201

Dear Mr. Player,

The American Council of Engineering Companies of South Carolina (ACEC-SC) is the only state organization devoted exclusively to the business and advocacy interests of engineering companies and is comprised of member firms committed to the professional practice of engineering in every sense of the word. Our mission is to advocate, advance and protect the business interests of engineering firms and standards of the engineering profession in South Carolina.

In 1998 ACEC-SC and the South Carolina Department of Transportation (SCDOT) entered into a partnering agreement. The mission of the Partnership is: *"To provide a forum for improving the coordination and understanding between SCDOT and the consulting community as it relates to the development of transportation projects. SCDOT and the consultants each have resources and expertise that should be combined in a coordinated effort for the mutual benefit of the traveling public and taxpayers of South Carolina."* ACEC-SC values this partnership and for 21 years we think we have worked together in fulfilling this mission.

We write you today to inform you that ACEC-SC opposes the use of an average overhead rate on fixed fees because we do not believe this practice to be in the best interest of South Carolina's Engineering Firms, the SCDOT or to the public. As stated above, ACEC-SC values our partnership with the SCDOT, and are going on record opposing the idea of SCDOT using an average overhead rate on fixed fees. The ACEC-SC/SCDOT Professional Services subcommittee and the ACEC-SC/SCDOT Partnering committee have had discussion on this subject, and before the discussion goes any further ACEC-SC wants SCDOT to know our thoughts on the issues.

Enclosed is a position statement approved by the ACEC-SC Board of Directors on the use of an average overhead rate for fixed fees. The document explains why we think it would be disservice to engineering firms and thereby potentially limiting the firms who seek to serve the SCDOT; the result of which would eventually increase project costs to taxpayers.

ACEC-SC would like to have a meeting with SCDOT to discuss this further and/or discuss it at the ACEC-SC/SCDOT Partnering Committee Meeting on Friday November 15, 2019.

Sincerely,

A handwritten signature in blue ink that reads "Adam B. Jones".

Adam B. Jones  
Executive Director

A handwritten signature in blue ink that reads "H. Keith Overstreet".

H. Keith Overstreet, PE  
2019-2020 Chairman of the Board

CC: Jennifer Necker

## ACEC POSITION ON SCDOT APPLICATION OF AVERAGE OVERHEAD RATES DURING CONTRACT NEGOTIATIONS FOR PROFESSIONAL ENGINEERING SERVICES

The American Council of Engineering Companies of South Carolina is the only state organization devoted exclusively to the business and advocacy interests of engineering companies and is comprised of member firms committed to the professional practice of engineering in every sense of the word. We represent engineering companies large and small; practicing in multiple sectors and markets; private development, government, transportation, water and sewer, just to name a few.

Many of our member firms are engaged in contracts with SCDOT and so they have a mutual interest with the Department in serving the citizens of the state by providing a robust and comprehensive transportation system. These firms have expressed concerns to ACEC-SC regarding SCDOT's use of an "average" overhead rate in the calculation of fixed fees for professional services.

ACEC-SC supports fair and honest negotiations conducted in good faith between the SCDOT and any professional engineers selected to provide services based on their qualifications. ACEC-SC supports:

- Total contract value based on an agreed to scope of work.
- Scope of work and associated fee that is satisfactory to both parties when negotiations are completed.
- Value pricing for professional services that appropriately take all considerations (risks and rewards) into account.

We do not support the following as these do not meet the objective for arriving at a scope of work and total contract value satisfactory to both parties.

- The use of arbitrary or "average" overhead rates to derive a fixed fee.
- The use of stipulated overhead rates and fixed fee percentages independent of the type of project under consideration.
- Fee concessions from professional firms without an associated adjustment in the scope of work.

Federal Highway Administration regulations require that contracting agencies must use and apply a consultant's cognizant approved indirect cost rate, or an accepted rate established in accordance with the FAR cost principles (as specified in 48 CFR 31), for the purposes of contract estimation, negotiation, administration, reporting, and contract payment on federally funded projects, and the rate shall not be limited by administrative or de facto ceilings of any kind (as specified in 23 U.S.C. 112(b)(2)(C)-(D) and 23 CFR 172.7(b)). Use of a statewide average indirect cost rate in the analysis of contract costs or the negotiation and administration of the contract creates an arbitrary limitation that is inconsistent with the principles of reimbursement of the total allowable costs of contract performance that are embodied in the Federal requirements. With respect to fixed fees, FHWA regulations require that the determination of the amount takes into consideration the scope, complexity, duration, size and type of contract, degree of risk, amount of subcontracting, and the professional nature of the services (23 CFR 172.11(b)(3)).

ACEC-SC member firms believe that "financial rewards" for firms are important for investment into their operations that aids in new technology advancement and a highly technical workforce. These investments also stimulate performance, improve overall firm stability, and can aid in reducing overhead rates. A fixed fee formula that reduces the effective fixed fee for any ACEC-SC member firm is not consistent with this objective, nor the objectives of FAR 15.404-4, which is meant to offer financial reward toward attracting the best capabilities of both large and small firms and maintaining the industrial base. Government agencies generally

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pay profit on labor and overhead (some also on non-salary items). Therefore, if profits are limited based on overheads this will not allow a firm to grow and creates a de facto ceiling on overheads which is inconsistent with the principles of reimbursement of the total allowable costs of contract performance that are embodied in the Federal requirements.

An arbitrary reduction of fees or overall contract costs is inconsistent with selection procedures (as specified in 23 U.S.C. 112(b)(2)(A), 40 U.S.C. 1104(a), and 23 CFR 172.5(a)(1)) for negotiation of fair and reasonable compensation considering the scope, complexity, professional nature, and estimated value of the services to be rendered. Reductions to overall contract costs also create a de facto ceiling on a firm's approved indirect cost rate required to be applied to contract negotiations and payment (as specified in 23 U.S.C. 112(b)(2)(D) and 23 CFR 172.7(b)) and could be viewed as creating an arbitrary reduction of direct salary/wage rates.

ACEC-SC members firms understand that contract negotiations are focused on establishing a Total Contract Value that meets SCDOT's program objectives and conforms to a mutually agreed upon scope of services. This overall contract value typically would not vary significantly between a Firm A or Firm B with different overhead rates, but how that contract value is determined does vary based on staff mix, project team firm mix and individual firm overhead rates.

A sample calculation is provided that shows the implications of this when Firm A has an overhead rate higher than the average and Firm B has an overhead equal to the average. As is demonstrated for this example, both firms will earn the full amount of the overhead and both firms will earn the identical amount of fixed fee. However, Firm A would be required to compensate for their higher overhead by reducing their labor to accomplish the work.

Firm A 200% Overhead

Firm B 150% Overhead

**Typical SCDOT Negotiation to Total Contract Value**

	Firm			Using Firm OH	
	Labor	OH on Labor	Fixed Fee %	Fixed Fee	Total Contract
Firm A	\$ 250,000.00	\$ 500,000.00	10%	\$ 75,000.00	\$ 825,000.00
Firm B	\$ 300,000.00	\$ 450,000.00	10%	\$ 75,000.00	\$ 825,000.00
Delta	\$ (50,000.00)			\$ -	

The sample calculation is repeated below for the case when fixed fee is instead computed based on the average overhead rate. In this case, Firm A can gain a nominal amount of direct labor cost and firms will earn the full amount of the overhead. However, Firm A will earn approximately 15% lower fixed fee than Firm B. Therefore, Firm A earns an effective fee percentage near 8% instead of the 10% that Firm B earns. This approach does not lead to fair and consistent treatment nor does it support the objectives previously noted.

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**SCDOT Negotiation to Total Contract Value with Fixed Fee Computed using Average OH Rate**

Assumed Average Overhead Rate =	150%				
	Firm			Using AVG OH	
	Labor	OH on Labor	Fixed Fee %	Fixed Fee	Total Contract
Firm A	\$ 253,846.16	\$ 507,692.31	10%	\$ 63,461.54	\$ 825,000.00
Firm B	\$ 300,000.00	\$ 450,000.00	10%	\$ 75,000.00	\$ 825,000.00
Delta	\$ (46,153.85)			\$ (11,538.46)	

As discussed above, determining contract value varies significantly between two project teams based on staff mix, project team firm mix and individual firm overhead rates. Therefore, a comparison of negotiations between two firms or teams on a purely hour-to-hour basis is not practical. This is also a very common issue during negotiations with SCDOT when discussing tasks and phases of work based on internal staffing assumptions. However, you examine the impacts, ACEC-SC member firms have concerns when efforts are considered to “normalize” fee calculations. ACEC believes that when Qualifications-Based Selection is required to be used, the capping of overheads or fees for the purposes of negotiation and payment may be contradictory to the performance of a firm and the quality of work that may be provided. Firms maintain a FAR audited overhead rate that ensures the same rules apply to all firms across the broad spectrum of services. Higher or lower overhead rates reflect more on the size of the firm, utilization of staff and/or the nature of its business, more so than a measure of efficiency and therefore adjusting the fixed fee based on the overhead rate is perceived as unfair to your professional engineering and CEI partners..

At the time a similar approach was implemented for CEI contracts, the procurement subcommittee structure for was not in place and/or had other missions and was not prepared to tackle this issue. Based on our member firms’ experience with this policy we are observing the negative impacts on our member firms described in the examples above and is not achieving its intended goal, and we therefore oppose this policy for all professional services. For this reason and those stated within, the vast majority of ACEC-SC member firms agree in their concern over, and opposition to, the use of “average” overhead rates in the calculation of fixed fees for professional services. In the same regard, ACEC-SC member firms are in one accord in appreciation to SCDOT for our ongoing collaboration and hope that this objection is accepted for consideration.