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IN RE APPEAL OF
ISLAND BUSINESS SYSTEMS & SUPPLIES

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)
) DECISION ON APPEAL
) No. BP-A024
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SUMMARY

This is an appeal by Island Business Systems & Supplies (IBSS) from the alleged failure of the Commonwealth Utilities Corporation (CUC) to decide on its protest pertaining to CUC's procurement of copying machines. Appellant IBSS protests the procurement method adopted by CUC in its procurement of copiers, asserting that CUC should have applied competitive procedures under CNMI Procurement Regulations (CNMI-PR) Section 3-103(5). CUC asserts that it was allowed by its procurement regulations (CUC-PR) to use the small purchase method on its copier procurement because the amount is below the threshold limit for full competition.

PROCEDURAL HISTORY AND FACTUAL BACKGROUND

On April 17, 2000, IBSS filed a protest with the CUC Executive Director against the lease of six copying machines from Xerox Corporation through a 48-month lease-to-purchase term. It claimed a violation of CNMI-PR Section 3-103(5), which requires any lease or purchase of vehicles, machinery or equipment to be procured through competitive sealed bidding. IBSS asked CUC to stop its procurement of six copying machines from Xerox and allow it, as well as other vendors, to compete in this procurement.

On May 30, 2000, IBSS filed an appeal with OPA after CUC failed to act on its protest within the time limit provided in its procurement regulations. IBSS' appeal largely repeated the arguments presented in its protest. On June 7, 2000, CUC submitted its response to the appeal, pointing out that its agreement with Xerox for copying services was only for six months, and was for less than \$25,000. CUC contends that it is not required by its procurement regulations to issue a solicitation in a procurement of this size.

On September 22, 2000, OPA was advised that CUC is renewing its six-month lease with Xerox for one year. CUC's legal counsel estimated the cost of the one-year lease renewal with Xerox at around \$22,000. OPA then requested a copy of the purchase order (PO) or any

agreement effecting the lease renewal. On November 21, 2000, CUC provided OPA with a copy of the PO (PO No. 01-0442, dated November 14, 2000). This PO formally renewed the lease of the six copiers with Xerox for one year in the amount of \$23,500. In his memorandum dated November 13, 2000 accompanying the PO, the CUC Executive Director cited the satisfactory performance of the Xerox machines as the basis for the renewal.

OPA's decision on this appeal is issued pursuant to CUC-PR Section 5-102(8)(c)(i), which provides that the Public Auditor shall issue a decision after all necessary information for the resolution of the appeal has been received.

ANALYSIS

We now discuss the arguments of IBSS and CUC as they were presented in the protest and appeal process, as well as our comments on the merits of the arguments.

In its protest and appeal, Appellant IBSS basically questions the methods and procedures adopted by CUC in its procurement of six Xerox copiers. IBSS points out that in April 2000, CUC was in the process of acquiring six Xerox copiers through a purported 48-month lease-to-purchase term. Appellant claims that CUC violated CNMI-PR Section 3-103(5) in procuring the copying machines without undertaking competition since IBSS did not either receive any invitation from CUC to submit quotations, or see any form of solicitation in the newspaper for this procurement. IBSS seeks cancellation of the award pursuant to CNMI-PR Section 5-103(2)(remedies after an award), as well as issuance of a solicitation to allow it, as well as other vendors, to compete in this procurement.

In response to the appeal, CUC laid out the events that led to the procurement of the six copiers, as follows:

1. CUC received a notice from Xerox that it could no longer service CUC's old copiers because of the unavailability of parts. Xerox then offered a trade-in and upgrade of the copiers with a long term lease (48 months).
2. CUC initially began to process a PO reflecting this long term lease, but this PO was subsequently canceled because it did not comply with the CUC-PR.
3. Prior to the exchange of machines, Xerox was advised that CUC would not enter into a long-term lease. However, CUC would accept the terms of Xerox's proposal on a six-month basis. A PO was then issued for six months on April 19, 2000 covering the six copiers.

CUC argues that its initial six-month lease with Xerox, which is less than \$25,000, does not require a solicitation of bids. According to CUC, such a requirement would be followed in

the event that it determines to enter into a long term agreement to lease or purchase copiers in the future.

OPA's Comments

Appellant IBSS asserts that CUC should have applied competitive procedures under CNMI-PR Section 3-103(5), which prohibits the use of the small purchase method for lease or purchase of machinery and equipment. CUC, on the other hand, states that its own procurement regulations allow for the use of the small purchase method, citing CUC-PR Section 3-103(1). IBSS' appeal apparently raises an issue of whether the CNMI-PR provisions apply to a CUC procurement, notwithstanding that CUC has adopted its own procurement regulations.

OPA's jurisdiction in protest appeals is limited to whether a solicitation, award or proposed award of a contract violated a law or regulation, and does not include reviewing the sufficiency and legality of an agency's procurement regulations. Such review is reserved to the Attorney General through its statutory duties to review rules and regulations prior to adoption. Unless the courts rule against the validity of the CUC-PR, the CUC-PR must be treated as valid regulations applicable to this procurement. Thus, we are dismissing the issue of whether the CNMI-PR apply to CUC's procurement of copying machines. The CUC-PR is the regulation that was legally adopted and currently applies to CUC's procurement of goods and services. Accordingly, we look to these regulations in adjudicating this appeal.

In reviewing the lease of the six Xerox copiers which is now the subject of this appeal, we have determined that CUC used the small purchase method in procuring the lease. In its protest, IBSS cited CNMI-PR Section 3-103(5), which provides an exception to the small purchase method, to wit: "This section shall not apply to lease or purchase of vehicles, machinery and equipment. Any lease or purchase of vehicles, machinery and equipment shall be procured pursuant to Section 3-102 or other applicable provisions..." However, there is no similar exception under the small purchase provisions of the CUC-PR. Accordingly, since we have determined that the CUC-PR applies to this procurement, we consider the issue on the small purchase exception moot.

In order to resolve the improper procurement procedure allegedly used by CUC, we now look at whether CUC's election of the small purchase method for its procurement of six copiers from Xerox is in compliance with the CUC-PR.

Whether the Use of Small Purchase Method Complies with the CUC-PR

We begin by reviewing the facts of the case based on the information presented by IBSS and CUC, as well as other information OPA obtained through interviews and examination of relevant documents.

On February 16, 2000, Xerox Corporation informed CUC that it could no longer service the old Xerox brand copiers due to unavailability of replacement parts and supplies. Xerox offered to replace these old copiers with newer models by outright purchase or “term-lease pool plan” for 48 months, while agreeing to accept six old units for trade-in. In a memorandum dated March 22, 2000, the executive director of CUC approved the lease proposal from Xerox. According to the purchasing supervisor, he subsequently met with the CUC comptroller to discuss how to go about the procurement of these copiers. In a memorandum dated March 23, 2000, the purchasing supervisor stated that “we are going to process this p.o. for six months, then we will process p.o. on every FY for four years since part of the agreement calls for 48 month lease agreement.”

CUC then prepared a PO (No. 00-1448) dated March 23, 2000 to cover the lease of six new copiers from Xerox for an initial period of 6 months. Item 1 to 6 of this PO contains the description and lease cost of the six copiers. Item No. 7, the last item in the PO, reads as follows: “ITEM #1 TO #6 ARE FOR 48 MONTH FIXED CPC PLAN. THIS P.O. IS FOR SIX MONTHS FROM APRIL 2000 TO SEPTEMBER 30, 2000....WE WILL CUT NEW PURCHASE ORDER ON FY FOR EVERY YEAR UNTIL 2004.” In a later interview, the purchasing supervisor explained that the six-month period was made to coincide with the fiscal year end of September 30, 2000.

According to CUC’s legal counsel, this PO came to her attention and was subsequently canceled because it did not comply with the CUC-PR. Our review of procurement records at CUC showed that a new six-month PO was issued to Xerox on April 19, 2000 in the amount of \$11,734.80, and it modified certain terms of earlier PO No. 00-1448. The new or replacement PO (also numbered 00-1448) generally contains the same items as the ones stated in the original PO, except that line item No. 7 was deleted, and one copier was upgraded to a higher model. By issuing a new or replacement PO, CUC had effectively modified earlier PO 00-1448 that originally called for the yearly issuance of POs to cover a total lease period of 48 months.

Towards the end of the initial 6-month lease, OPA was advised that CUC was renewing its lease with Xerox for one year. Accordingly, on November 14, 2000, CUC formally renewed its lease with Xerox from October 01, 2000 to September 30, 2001 for \$23,469.60¹, in which it cited the satisfactory performance of the Xerox copiers.

The grounds presented on the appeal, which were the same protest grounds raised with CUC, mentions an alleged 48-month lease-to-purchase term with Xerox. As discussed above, CUC originally intended to go through with a 48-month lease term with Xerox (through a series of POs). However, such scheme was modified through the subsequent issuance of a new or

¹ This amount only pertains to the 1 year lease cost of the 6 copier units. The PO issued also covered; (1) lease of 1 additional copier for \$2,883.12, and (2) various maintenance agreements with Xerox for CUC’s other copiers and fax machines for \$7,500. This brings the total PO amount to \$33,852.72 (for all 3 items).

replacement PO that removed the 48-month provision in the original PO. Since the 48-month lease being appealed was corrected by CUC, we consider this particular issue moot.

In its protest, IBSS mainly questions the procurement of the Xerox copiers without soliciting bids or proposals. The lease with Xerox was not issued with an invitation for bids (IFB) or a request for proposals (RFP) because, according to CUC, it was only a six-month lease, and its corresponding amount was only about \$12,000. CUC contends that this particular procurement qualifies under the criteria for a small purchase under the CUC-PR.

The CUC-PR, as well as the CNMI-PR, requires the use of competitive sealed bidding in every procurement, unless the particular procurement qualifies under other specified methods. Included in these other methods is the small purchase procurement method. If the lease with Xerox meets the threshold amount for a small purchase, then the procedures for small purchase under Section 3-103 may be used instead of the issuance of an IFB. Subsections (2) to (4) of CUC-PR Section 3-103 (Small Purchases) provide that:

- (2) No bidding is required for procurement under \$25,000.00.
- (3) For procurement valued at \$25,000 to \$50,000, the Director must obtain price quotations from at least three (3) vendors and base the selection on competitive price and quality.
- (4) Purchase orders may be utilized for small purchases in paragraphs (2) and (3) only. In no other instances may purchase orders be utilized instead of contracts.

The six-month lease with Xerox covered by PO No. 00-1448 was below the \$50,001 threshold amount for competitive bidding, and is well within the \$25,000 threshold for small purchases without obtaining three price quotations. Even if CUC opted to enter into a one-year lease using a PO, the amount is within the \$25,000 threshold, and price quotations are still not required. Accordingly, the amount of the initial six-month lease with Xerox qualified for the the small purchase method.

Since the subject of the protest and appeal was limited to the terms of the original PO, we need not consider the subsequent renewal of the initial six-months lease with Xerox. However, for purposes of providing guidance in this situation, we now include a discussion of the lease renewal, and its impact on whether bidding should have been undertaken.

If we include the subsequent renewal of the initial six-month lease of one year (or a combined term of eighteen months), the total procurement amount would exceed \$25,000, and CUC would have been required to obtain three price quotations. However, there is no specific provision in the CUC-PR that requires renewals to be included in determining whether a procurement qualifies under the small purchase method. The CUC-PR does provide a prohibition under Section 3-103(1), which requires that procurements shall not be artificially divided so as to constitute small purchases. A reasonable application of this prohibition in a

lease procurement is that an agency is prohibited from dividing a long term lease into a series of short term leases, constituting small purchases.

The CUC-PR does not provide guidelines of when to use short term or long term leases. The term “artificial division” was also not defined in the CUC-PR. However, the one-year renewal in this case could be considered in determining the total procurement amount, if this renewal was something that was planned or intended under the initial six-month lease. If such was the case, then the use of the six-month lease would be inappropriate, and it could be concluded that CUC artificially divided the term of the lease to avoid the bidding process. It was important, therefore, that we establish whether CUC initially intended to renew the lease of the six copiers after completion of the six-month lease.

It was not clear whether CUC intended to lease the six copiers for just six months or for a longer period when it entered into a six-month lease with Xerox. CUC’s original plan to enter into a 48-month lease for these copiers suggests that CUC intended to lease the copiers on a long term basis, since most of the copiers had already been delivered on April 13, 2000² - a few days *before* CUC deleted the long term provision in its replacement PO of April 19, 2000. However, the fact that CUC deleted the long term provisions of its lease a few days after receipt of most of the copiers raises some doubt about such an intention. The replacement PO explicitly deleted the 48-month lease term stated in the old PO, and this makes any commitment made by CUC under the old PO non-binding.

Additionally, we doubt that CUC intended to enter into a long term lease, because our interviews with Xerox and CUC representatives revealed that when the 48-month term was canceled, there was no commitment for any renewal. Also, CUC’s report on the appeal stated that CUC had previously advised Xerox that it would not enter into a long term lease. The fact that CUC subsequently renewed the lease for one year does not conclusively prove CUC’s intent to enter into a long term lease. The renewal appeared to be necessary to meet CUC’s current needs while it explores other options to meet its photocopying needs.

CUC’s legal advisor explained in her letter dated September 18, 2000 (received by OPA on September 22) that CUC will not enter into a long term lease agreement because it is interested in exploring new technologies for copiers, such as the possibility of setting up a local area network (LAN) that would enable copying (as well as faxing) documents from a computer. Thus, in a memorandum, the CUC executive director gave the following instruction to the CUC P&S manager: “Meet with EDP to explore the current available technology that links our office computers to each other and to copying and fax machines.”

² Based on delivery documents, four copiers were delivered to CUC on April 13, 2000, and one copier was delivered on April 22, 2000. The delivery document for one other copier was not provided to us. Additionally, one of the copiers delivered on April 13, 2000 was replaced with another copier in late April 2000, according to the purchasing supervisor. Although the copiers were delivered in April 2000, CUC started making payments for its six months lease with Xerox in September 2000, five (5) months after the replacement PO was executed.

The director gave the P&S manager until March 2001 to submit a report on his research. The director also asked his P&S manager “to include any other information...that would be helpful in determining what direction to take in this area.”

In its report on the appeal, CUC added that it will follow the bidding requirements should it enter into a long term agreement to lease or purchase copiers in the future. We conclude, in this case, that CUC has a reasonable basis for its current short term lease since its photocopying needs may well change significantly over the next few years. In the Federal Government, the U.S. General Accounting Office (GAO) provided some guidelines in a somewhat similar situation. In a GAO protest involving the solicitation for dispatch, security and monitoring services, it states that “...the record reflects that the value of a 1-year contract is below the \$3 million threshold at which a competition is required, whereas a contract providing for a 1-year base period with four 1-year options would exceed the \$3 million threshold and would thus have to be competed....” *Champion Business Services, Inc.*, B-283927, January 24, 2000 (Agency report at 3). In that protest, it was alleged that the requirement was truncated into smaller one-year awards in order to circumvent the competitive threshold. In its decision, GAO stated that the agency has a reasonable basis for the solicitation of a 1-year contract since the program was new and undergoing considerable change, which may well lead to extensive changes over the next few years in the agency’s requirements.

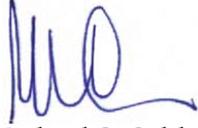
In this case, we conclude that the use of the short term lease was not a violation of the CUC-PR. We caution, however, that continued non-bidder renewals of the lease with Xerox beyond the current lease term may evidence CUC’s intent of holding the photocopiers on a long term basis. We believe that the current lease term of one year should allow enough time for CUC to determine what specific photocopiers it will need to satisfy its requirements in future years. CUC should not continue using these photocopiers in future years through non-bidder short term leases, because doing so might compromise the integrity of CUC’s procurement system. The purpose and policies of the CUC-PR, as provided in Section 1-101(2), include (1) providing safeguards for the maintenance of a procurement system of quality and integrity, and (2) fostering effective broad-based competition within the free enterprise system.

DECISION

The Office of the Public Auditor hereby *denies* this appeal.

Section 5-102(9) of the CUC-PR provides that the appellant, any interested party who submitted comments during consideration of the protest, the Director, and any agency involved in the protest, may request reconsideration of a decision by the Public Auditor. The request must contain a detailed statement of the factual and legal grounds for which reversal or modification is deemed warranted, specifying any errors of law made or information not previously considered. Such a request must be received by the Public Auditor not later than

ten (10) days after the basis for reconsideration is known or should have been known, whichever is earlier.



Michael S. Sablan
Public Auditor

January 25, 2001