BAKER DONELSON
BEARMAN, CALDWELL & BERKOWITZ, PC

901 K STREET, N.W.
SUITE 900
WASHINGTON, D.C. 20001

PHONE: 202.508.3400
FAX: 202.508.3402

www.bakerdonelson.com

To: Martha Duggan
Senior Director, Regulatory Affairs
National Rural Electric Cooperative Association

From: Ernest B. Abbott and Liz Cappiello

Date: October 4, 2019

Re: Material Handling Costs

You have asked us to analyze for the National Rural Electric Cooperative Association whether electric cooperatives can successfully seek, as part of their requests for disaster assistance under FEMA's Public Assistance Program, reimbursement of handling costs on materials that have been sold by certain cooperatives to their member cooperatives for use in power restoration or reconductoring projects resulting from major disasters declared by the President. We understand the principal concern is whether this arrangement will be deemed an impermissible cost plus percentage of cost contract under Federal grant regulations.

Some electric distribution co-ops have created purchasing cooperatives in order to both aggregate buying power among a larger group through scale (therefore driving down the costs of materials) as well as to respond quickly in times of disaster with sufficient materials and supplies to be able to restore electric power quickly and safely in the much less densely populated areas most electric cooperatives serve. Some of these entities are separate not-for-profit entities and others are part of the non-profit statewide electric cooperative organizations. For purposes of this memo, we will refer to both types of entities as Materials, Supplies and Inventory cooperatives or MS&I cooperatives.[1]

We have reviewed the federal grant procurement regulations relating to cost plus percentage of cost contracts, similar regulations in the Federal Acquisition Regulation and cases decided thereunder, and related guidance from FEMA and FEMA's Procurement Disaster Assistance Team. Based on this analysis, we believe that the applicable regulations and policies should permit members to include handling charges on materials paid to MS&I cooperatives in their requests for reimbursement under FEMA's Public Assistance Program – but with several significant caveats. First, the costs must be actual costs, segregated from other costs; second, the costs submitted for reimbursement must be net of any refunds of margins that MS&I cooperatives provide to their members; and third, the MS&I cooperatives should document the accounting basis for the handling costs. Nonetheless, FEMA has wide discretion in determining the work and costs which are eligible for reimbursement under its Public Assistance Program, and remedies to member cooperatives would be limited should FEMA take a different view.

[1] These entities are also sometimes known as T-Cooperatives to denote the not-for profit nature of these entities under IRS Code section 1381, subsection T. 2.

Analysis

A. General Description of MS&I Cooperative Purchasing Programs

MS&I cooperatives, as part of services provided to their members, purchase and resell to their member cooperatives the materials used in constructing, maintaining, and repairing power transmission and distribution facilities for both day-to-day use and in response to federally declared and other disasters. In these arrangements, the MS&I cooperatives enter into contracts with vendors for the purchase of materials; then, when the member cooperatives are in need of materials, they purchase directly from the MS&I cooperatives. These arrangements frequently include the cost of the maintenance of inventories of materials sufficient to allow prompt delivery of materials as needed by all member cooperatives across the state or region. The MS&I cooperatives have frequently charged the cooperative members at cost for the materials, plus a handling charge that is normally expressed as a percentage of the cost of the materials themselves. Because the MS&I cooperatives are non-profit cooperative organizations, the handling charges do not provide profit to the MS&I cooperatives but are set at the estimated cost incurred by the MS&I cooperative to cover the administrative, procurement, and inventory management (if any) costs of the program. Any excess of the MS&I cooperative's receipts from its sale of materials over the cost of the program are then refunded to its members.

B. The Issue Presented

Cost plus a percentage of cost ("cost plus % of cost") contracts are prohibited under the Federal Acquisition Regulations ("FAR") and Federal grant regulations. *See* 48 C.F.R. § 16.102(c); 2 C.F.R. § 200.323(d). The issue at hand is whether FEMA may determine that, by charging material handling costs on top of the material costs, the MS&I cooperatives and the member cooperatives may have entered into impermissible cost plus % of cost contracts.

The majority of guidance dealing with material handling costs, and their allowability under Federal contracts and Federal grants, involves time and materials contracts because it is in this scenario that the issue most frequently arises of whether a prohibited cost plus % of cost contract is created. The MS&I cooperatives are not entering into time and materials contracts with the member cooperatives, but this guidance should be consulted to consider whether these arrangements create impermissible cost plus % of cost contracts. Based on the available guidance, it appears that material handling costs can be charged to Federal grants in certain circumstances as described below.

C. FAR/Federal Grant Guidance

Both the FAR and 2 C.F.R. Part 200 prohibit the use of cost plus % of cost contracts. However, time and materials contracts are permitted under both regulations and both the FAR and Federal grant regulations contain guidance about how material costs are handled under these contracts.

1. Federal Grant Regulations

The Federal grant regulations do not expressly state that material handling costs are permissible costs, but based on the regulations and other guidance, it appears that material handling costs can be charged to a Federal grant under certain circumstances. Part 200 of 2

C.F.R contains provisions about permissible costs under the Federal grants. Section 200.318 states, in pertinent part:

> (j)(1) The non–Federal entity may use a time and materials type contract only after a determination that no other contract is suitable and if the contract includes a ceiling price that the contractor exceeds at its own risk. Time and materials type contract means a contract whose cost to a non–Federal entity is the sum of:
>
> (i) The actual cost of materials; and
>
> (ii) Direct labor hours charged at fixed hourly rates that reflect wages, general and administrative expenses, and profit.
>
> (2) Since this formula generates an open-ended contract price, a time-and-materials contract provides no positive profit incentive to the contractor for cost control or labor efficiency. Therefore, each contract must set a ceiling price that the contractor exceeds at its own risk. Further, the non–Federal entity awarding such a contract must assert a high degree of oversight in order to obtain reasonable assurance that the contractor is using efficient methods and effective cost controls.

(emphasis added).

Section 200.453, which is not specific to time and materials contracts, sets forth the provisions in the Federal grant guidance dealing with materials costs. This section states:

> (a) Costs incurred for materials, supplies, and fabricated parts necessary to carry out a Federal award are allowable.
>
> (b) Purchased materials and supplies must be charged at their actual prices, net of applicable credits. Withdrawals from general stores or stockrooms must be charged at their actual net cost under any recognized method of pricing inventory withdrawals, consistently applied. Incoming transportation charges are a proper part of materials and supplies costs.
>
> (c) Materials and supplies used for the performance of a Federal award may be charged as direct costs. In the specific case of computing devices, charging as direct costs is allowable for devices that are essential and allocable, but not solely dedicated, to the performance of a Federal award.
>
> (d) Where federally-donated or furnished materials are used in performing the Federal award, such materials will be used without charge.

(emphasis added).

2. The FAR Guidance

While the procurement of materials by the electric cooperatives is governed by the Federal grant regulations, it is useful to look to the FAR for additional guidance. Importantly, the FAR specifically states that material handling costs can be charged on time and materials contracts. Specifically, 48 C.F.R. § 16.601(c)(3) states:

> Material handling costs. When included as part of material costs, material handling costs shall include only costs clearly excluded from the labor-hour rate. Material handling costs may include all appropriate indirect costs allocated to direct materials in accordance with the contractor's usual accounting procedures consistent with Part 31.

Part 31 deals with costs under various contract forms. 48 C.F.R §31.205-26, which is not specific to time and materials contracts, sets forth the provisions about material costs under the FAR in contracts with commercial organizations. It states the following:

> Material costs.
>
> (a) Material costs include the costs of such items as raw materials, parts, subassemblies, components, and manufacturing supplies, whether purchased or manufactured by the contractor, and may include such collateral items as inbound transportation and in-transit insurance. In computing material costs, the contractor shall consider reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provision relating to inspecting and correcting defective work).
>
> (b) The contractor shall -
>
> (1) Adjust the costs of material for income and other credits, including available trade discounts, refunds, rebates, allowances, and cash discounts, and credits for scrap, salvage, and material returned to vendors; and
>
> (2) Credit such income and other credits either directly to the cost of the material or allocate such income and other credits as a credit to indirect costs. When the contractor can demonstrate that failure to take cash discounts was reasonable, the contractor does not need to credit lost discounts.
>
> (c) Reasonable adjustments arising from differences between periodic physical inventories and book inventories may be included in arriving at costs; provided such adjustments relate to the period of contract performance.

> (d) When materials are purchased specifically for and are identifiable solely with performance under a contract, the actual purchase cost of those materials should be charged to the contract. If material is issued from stores, any generally recognized method of pricing such material is acceptable if that method is consistently applied and the results are equitable.
>
> (e) Allowance for all materials, supplies and services that are sold or transferred between any divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control shall be on the basis of cost incurred in accordance with this subpart. However, allowance may be at price when -
>
> (1) It is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary or affiliate of the contractor under a common control; and
>
> (2) The item being transferred qualifies for an exception under 15.403-1(b) and the contracting officer has not determined the price to be unreasonable.
>
> (f) When a commercial item under paragraph (e) of this subsection is transferred at a price based on a catalog or market price, the contractor -
>
> (1) Should adjust the price to reflect the quantities being acquired; and
>
> (2) May adjust the price to reflect the actual cost of any modifications necessary because of contract requirements.

(emphasis added).

D. Case Law and Administrative Guidance

There is little case law dealing with whether charging material handling costs to a federal contract or a federal grant would create a prohibited cost plus % of cost contract.

One of the main cases dealing with material handling costs is *General Eng. & Mach. Works v. O'Keefe*, 991 F.2d 775 (1993). This case involved a federal contract that was subject to the Defense Federal Acquisition Regulations ("DFARS"). The United States Court of Appeals for the Federal Circuit explained that "[m]aterial handling costs may be paid to a contractor either as a percentage of the total cost of the materials or as part of general overhead. It is therefore possible for a contractor to receive material handling cost payments twice, and such error would be difficult to verify if all funds are kept in the same cost pool by the contractor." *Id.* at 780.

In this case, the contractor included a 15% material charge in its contract proposal. These material handling charges "covered the labor costs associated with handling the material and transporting it to the work site and the expenses incurred from ordering, receiving and inspecting the material." *Id.* at 778 n.4. However, it was the contractor's practice to include the material handling costs in its overhead pool. The Court determined that the Navy was entitled to reimbursement of $86,775 in material handling fees because the contractor failed to maintain the material handling charges in a separate cost pool. *Id.* at 778. The Court also noted that

> [T]he payment of material handling costs through both overhead rates and a percentage mark-up would constitute an impermissible cost-plus-percentage-of-cost system of contracting. Section 7-901.6 [DFARS] is mandatory for all time and material contracts, 32 CFR sec. 7-901, and discourages a cost-plus-percentage of cost system of contracting by requiring contractors to segregate those charges in separate pools.

Id.

One of the cases cited in *General Eng.* and one of the seminal cases on cost plus % of costs contracts, is *Urban Data Systems, Inc. v. U.S.*, 699 F.2d 1147 (1983). In *Urban*, the United States Court of Appeals for the Federal Circuit determined that price adjustment clauses in subcontracts were cost plus % of cost provisions in violation of federal statute and were therefore invalid. The Court in *Urban* explained that it applied the general criteria developed by the Comptroller General for determining whether contract was a cost-plus-a-percentage-of-cost contract:

> 1) payment is on a predetermined percentage rate; (2) the predetermined percentage rate is applied to actual performance costs; (3) the contractor's entitlement is uncertain at the time of contracting and (4) the contractor's entitlement increases commensurately with increased performance costs.

Id. at 1150.

These are the factors courts will consider in deciding whether a federal contract is a prohibited cost plus % of cost contract. The concern in these types of contracts is that contractors will unnecessarily increase costs because with more costs, comes more profit. Specifically, the Court in *Urban* explained that:

> The prohibition against cost-plus-a-percentage-of-cost contracts protects against exploitation of the government's resources by contractors who might take advantage of the open-ended system by unduly increasing costs—and thus their profits—or might simply enjoy the spur of an incentive to increase costs (deliberately or carelessly) by being unconcerned, profligate, or wasteful. At the same time, Congress's prohibition tends to prevent the development of a

> "buddy system" between contractors and government procurement officials in which the latter might favor some contractors with the well-known advantages of that form of contracting. Were the statutory prohibition inapplicable to agreements stipulating a ceiling price, the contracting parties could avoid the legislative stricture simply by setting high ceilings. We cannot imagine that Congress envisioned such a loophole in establishing protection for the Government against the exploitation possible in cost-plus-a-percentage-of-cost contracts.

Id. at 1152.

In *Benmol Corp. v. Dept. of the Treasury*, G.S.B.C.A. No. 16374 TD, 04-2 B.C.A. (CCH) ¶ 32669, 2004 WL 1517779 (Gen. Services Admin. B.C.A. July 6, 2004), the General Services Board of Contract Appeals stated that "[t]he preferred way of demonstrating proper allocation [of material handling costs] is to establish and implement a separate cost pool for material handling costs." *Id.* at 161,699. In *Benmol*, the Board determined that a contractor was entitled to recover material handling fees pursuant to FAR clause 52.232-7, which was incorporated into its contract with the government. *Id.* However, in a later decision by the Board, the contractor was denied any recovery because the contractor had failed to "'account[] for [material handling costs] appropriately and . . . maintain[] records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in . . . subpart [31.2]'". *See Benmol Corp. v. Dept. of Treasury*, G.S.B.C.A. No. 16374-TD, 05-1 BCA P 32897, 2005 WL 375530 (Gen. Services Admin. B.C.A. Feb. 15, 2005). This decision demonstrates the importance of proper documentation of material handling costs.

We have not reviewed the material and inventory sales programs of all MS&I cooperative purchasing programs to confirm whether they include any overhead costs at all in the "cost" of materials sold to their members, other than the markup for handling costs. But if an MS&I cooperative is not charging overhead charges in its material costs (in addition to the "handling charges" discussed in this memorandum), and are able to document that the handling charges are costs actually incurred that are not otherwise recovered by the MS&I cooperative, then based on the above case law and administrative decisions, they should be able to seek reimbursement for material handling costs because factor 2 of the four-part test set forth in *Urban Data Systems* would not be satisfied and the state-wide cooperatives would not be double billing.

E. FEMA Second Appeals Guidance

On August 13, 2019, FEMA issued Second Appeal Analysis, FEMA-1858-DR-GA, PA ID 121-03E97-00, *City of Atlanta, PWs 594 and 1883*. In this appeal analysis, FEMA determined that a 15% markup for equipment and materials not included on the contract rate sheet created an impermissible cost plus % of cost provision. The applicant in this matter had a T&M contract with "fully loaded rates established." *Id.* at 13. It later agreed to a 15% markup on equipment and materials that were not included on the contract rate sheet. The Applicant argued that 44 C.F.R. § 13.36(f)(4) "does not specify that a T&M contract is

converted to a [cost plus % of cost] contract when it includes a 15 percent markup for materials-handling fees." *Id.*

FEMA determined that this portion of the contract met "the four-part test to determine reimbursement is based on a [cost plus % of cost] method of contracting, as it (1) included payment based on predetermined rate of 15 percent; (2) applied a rate to actual rented equipment and material costs; (3) the equipment and materials costs were unknown at the time of contracting; and (4) the contractor's cost increased with additional rented equipment and material costs."

The facts in the *City of Atlanta* matter are distinguishable from the facts at issue here. First, unlike the MS&I cooperatives' sales to their member cooperatives, in the *City of Atlanta*, the contract at issue was a T&M contract. In the case of MS&I cooperatives, the contract is generally for the sale of materials. Second, in its decision FEMA emphasized the reason that cost plus % of cost contracts are prohibited is because they "incentivize a contractor to increase its profits by increasing costs of performance." *Id.* at 12.

This risk is not present for MS&I cooperative purchasing programs for two reasons. First, it is not possible in a materials supply contract for the MS&I cooperative to increase profits by increasing costs of performance. The only "costs of performance" are the cost of the materials supplied by the MS&I cooperative to its members. There is no way for the MS&I cooperative to "increase the cost of performance" to increase its profit, because the buyer/member cooperative has complete control over how many poles, wires, insulators, conductor, transformers, etc. that it orders. The MS&I cooperative does not charge for materials that the buyer/member cooperative does not order. For this reason, the third part of the four-part test for cost-plus percentage-of-cost contracts is not met: for every item sold under this program, the cost of performance is certain: it is the materials cost plus the applicable handling fee.

Second, the MS&I cooperatives are non-profit organizations. The materials that they sell are delivered to their members at cost. The handling fee charged by the MS&I cooperative is to cover the administrative and overhead and inventory costs incurred by the MS&I cooperative in procuring, storing and delivering materials to its member cooperatives on request. The amount of the handling charge is based on an estimate of the charge required to break even on this sales service. Where the MS&I cooperative determines that it has received greater revenue from its handling charges than the costs it incurred, the excess is then distributed to the member cooperatives consistent with the cooperative's non-profit status.

While the *City of Atlanta* matter differs from the present situation, FEMA's second appeal analysis does demonstrate the care that must be taken in requesting reimbursement for charges of this type. But note that there was no information provided by the applicant in *City of Atlanta* that indicated that it was the City, and not the contractor, which determined how many of the 'units' that were subject to the handling charge were delivered (e.g., how many port-a-potties and hazard materials collection barrels were delivered to the job site). The contractor in *City of Atlanta* arguably could have delivered more hazard materials barrels and port-a-potties than were needed to increase its profit. By contrast, the MS&I cooperatives do not get to decide how many of each type of materials they charge for – it is the buyer who specifies the exact number of materials purchased. Further, while the applicant in *City of*

Atlanta argued that the 15 percent markup was for "handling transactions tied to renting any equipment that was not specified on the rate sheets" and that "the prices for rentals were not loaded prior to the application of the contractor's markup", it is unclear from the written analysis whether the applicant had a proper accounting basis for the 15 percent charge or whether the applicant had documentation to support the charge. *Id.* at 11. The MS&I cooperatives need to ensure that any handling costs have an accounting basis and represent actual costs incurred to store and handle the materials at issue. Similarly, the price of the materials sold to the member cooperatives "at cost" must not already include a material handling fee because this would result in duplicate billing.

F. Other Guidance

FEMA's Field Manual provides some additional guidance on cost plus % of cost contracts. Specifically, the Field Manual explains that the previously discussed four-part test "can be utilized to determine if a certain contract is a prohibited [cost plus % of cost] contract." Field Manual at 81. The Field Manual includes an example of a cost plus % of cost contract. In the example, the contractor added a 19.3 percent markup to hourly T&M billings for its employees. Importantly, these hourly rates were already "fully burdened, which means they included profit and overhead." *Id.* at 82.

In the present case, the material costs charged by the MS&I cooperatives to the member cooperatives are not fully burdened prior to a markup for handling fees. The MS&I cooperatives charge the member cooperatives at cost for the materials, plus the actual costs associated with handling the materials. Therefore, the Field Manual does not indicate that material handling fees in this case would be disallowed.

The Federal Transit Administration ("FTA") oversees thousands of grants provided to states, tribes, and local public agencies to support public transportation. Federal grants awarded by the FTA are subject to 2 C.F.R. Part 200. The FTA's website contains a section on frequently asked questions. Notably, the FTA provides guidance on charging material handling costs on Federal grant work overseen by the FTA. Some of this guidance may help craft an argument to FEMA that it should be entitled to charge material handling costs. It should be noted, however, that these questions relate to material costs in time and materials contracts.

The following are four questions and the relevant portions of the answers found on the FTA's website, with emphasis added:

> **Q. Could you tell me exactly what are Time and Materials and Fixed Price contracts?**
>
> **A.** Time-and-materials (T&M) contracts may be used for acquiring supplies or services. These contracts provide for the payment of labor costs on the basis of fixed hourly billing rates which are specified in the contract. These hourly billing rates would include wages, indirect costs, general and administrative expense, and profit. There is a fixed-price element to the T&M contract - the fixed hourly billing rates. But these contracts also operate as cost-type contracts in the sense that labor hours to be worked, and paid

for, are flexible. Materials are billed at cost, unless the contractor usually sells materials of the type needed on the contract in the normal course of his business. In that case the payment provision can provide for the payment of materials on the basis of established catalog or list prices in effect when the material is furnished. These contracts also may provide for the reimbursement of material handling costs, which are indirect costs, such as procurement, inspection, storage, payment, etc. These indirect costs are billed as a percentage of material costs incurred (similar to the billing of overhead costs as a percentage of direct labor). Such material handling costs must be segregated in a separate indirect cost pool by the contractor's accounting system and must not be included in the indirect costs included as part of the fixed hourly billing rate for direct labor. It would always be prudent to obtain a pre-award audit of the contractor's accounting system to determine the adequacy of the system to properly segregate material handling costs from other overhead costs being billed with the fixed hourly rates for labor. There is a full discussion of time and materials contracts in Section 2.4.3.3 of the FTA Best Practices Procurement Manual. **(Revised: June 2010)**

Q. We are trying to determine a "reasonable" material handling cost. The contractor is trying to charge their General and Administrative (G&A) expenses - but as the fixed rate is three times the amount paid the employee - it appears G&A is a part of their labor rate. What is the basis for material handling costs, i.e., what types of charges are allowed? Aren't rates usually 5-10% of the materials?

A. The Federal Acquisition Regulations (FAR) in its discussion of Time and Materials contracts at subpart 16.601 (b) (2) says that material handling costs are to include only those costs that are clearly excluded from the "labor hour rate." The labor hour rate would include direct labor cost (salary) and overhead charges (and/or G&A charges). In other words, the material handling costs must be segregated in a separate indirect cost pool from the other overhead and G&A costs. Material handling costs would typically include such functions as receiving, inspection, storage and distribution of materials. You are correct in saying that material handling rates are usually less than 10% of the material costs themselves. If the contractor does not have a separate material handling pool, you can negotiate an advance agreement in the contract requiring such a pool, as

> well as advance agreement on the components of the pool, and place a cap or ceiling on the rate, adjustable downward only at the time of final cost audit. You should not use a predetermined (fixed) material handling rate as this could be interpreted an impermissible cost-plus-percent-of-cost contract. If the contactor will not agree with you and continues to insist on a G&A charge that produces inequitable cost results to your agency, you could also buy the materials and furnish them to the contractor as "owner/agency furnished materials." This would void any markup though it would of course be an administrative burden for your agency. **(Revised: June 2010)**
>
> **Q. Please explain the 'make-up' of Time and Material rates. It is my understanding that no fee is to be applied to any cost other than labor. It states that material burden can be applied to material, provided that the cost is not already included in the labor rate. What about travel, can a Contractor apply any burdens to travel? Please elaborate on what can and cannot be applied to the various elements of cost.**
>
> **A.** You are correct in your statement that no fee or profit is allowed except as part of the fixed billing rate for direct labor hours. To fix a fee rate in the contract and allow the contractor to bill for actual costs (e.g., materials or travel) plus that rate of fee would constitute a prohibited cost-plus-percent-of-cost contract. A contractor is allowed to recover overhead costs on its direct costs, such as materials or travel, if the contractor's accounting system clearly separated the overhead costs associated with those direct costs (e.g., in a material handling overhead pool), and those overhead costs are not included in the overhead pool that is applied to direct labor costs. In other words, there must be no duplicate billing for material handling overhead costs in the rates applied to labor dollars and material dollars. The Contractor must consistently charge all contracts using the same methodology.

See https://www.transit.dot.gov/funding/procurement/third-party-procurement/time-materials-contracts.

In this guidance, it is clear that DOT did not find a percentage fee for handling costs on materials supplied as part of a time and materials contract to be objectionable. The concern of DOT was that the labor and other unit rates under the time and materials contract may include some of the costs upon which the handling costs were based – leading to duplicate recovery of costs. This concern is not present in the MS&I cooperative purchasing programs, where there are no labor rates and the cost of materials includes no overheads or

other allocations that might be included in the handling costs. The guidance also explains that material handling must be segregated in a separate indirect cost pool by the contractor's accounting system.

Conclusion

The MS&I cooperatives should be able to charge material handling costs because, after considering the relevant regulations, case law, administrative guidance and other sources, it appears that material handling costs can be charged to Federal grants in certain circumstances. The MS&I materials purchasing programs as described in this memorandum do not meet several of the tests used by the courts and FEMA to determine whether handling charges under the program create an impermissible cost plus % of cost contract.

A costs plus % of cost contract is present when:

> 1) payment is on a predetermined percentage rate; (2) the predetermined percentage rate is applied to actual performance costs; (3) the contractor's entitlement is uncertain at the time of contracting and (4) the contractor's entitlement increases commensurately with increased performance costs.

Notably, the material handling costs charged by the MS&I cooperatives are not some predetermined percentage fee designed to provide the MS&I cooperatives with a profit. Based on the known facts, these handling costs are actual costs incurred by the MS&I cooperative in procuring, maintaining, and transporting the relevant materials. It is also understood that the MS&I cooperatives are not double billing for these costs because the materials are sold at cost to the member cooperatives and a material handling charge is added on top to cover the actual costs to the MS&I cooperatives of handling the materials. Further, for every item sold, the cost of the product is fixed at cost, plus the percentage assessed as handling costs. The MS&I cooperative contractor cannot increase its profit by increasing the number of items supplied – first because the MS&I cooperative is a not-for-profit entity and second because the MS&I cooperative must supply only the items ordered by the buyer/member cooperative. The MS&I cooperatives, however, will need to ensure that any material handling costs are kept separate from other costs and that they have a valid accounting basis for charging such costs.

The contractual relationships that MS&I cooperatives have with their member cooperatives for the procurement of materials are unique arrangements. There is a strong argument for why FEMA should have no issue with it charging material handling costs for maintaining, transporting, inspecting, and procuring materials, but it is advisable to discuss this issue with FEMA.