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Can DoD Be "The Biggest Loser"? Gates Unveils DoD's New Fiscal Diet Plan

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Article By
Alexander W. Major
Sheppard, Mullin, Richter & Hampton LLP

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After a decade of increasing appetite for defense dollars, the Pentagon appears to have stepped on a scale and decided to make some changes. Following-on from the Department of Defense's June 2010 announcement regarding changing its procurement business models, Defense Secretary Robert Gates and Under Secretary of Defense for Acquisition, Technology and Logistics, Ashton Carter, recently unveiled their proposed procurement changes intended to redirect $100 billion over the next five years. Like the lifestyle changes made by contestants on television's "The Biggest Loser," the proposed measures, referred to collectively as a "wide ranging Efficiencies Initiative," are an attempt to demonstrate to Congress that the Department can trim the fat, tighten the belt and use its hefty $700 billion annual budget in a healthier way.

As written, the Pentagon's guidance contains five general areas of improvement with 23 principal actions the Department will implement to thin-down and shape-up. For DoD, these *lifestyle* changes include new "Milestone" requirements that projects must meet before continuing in the acquisition process, organizational and staff changes throughout the Department, and significant changes in the way offices solicit, negotiate, and manage their contracts. For contractors, however, the guidance means dealing with a Defense Department focused on a diet and exercise regimen consisting of affordability, productivity, and competition in a time when troop withdrawals may be signaling continued budget cuts.

DoD Initiative: Target Affordability and Control Cost Growth

A key factor in the announced changes is the Department's intent "to treat affordability as a requirement" throughout the acquisition cycle. While a clear directive is promised, it is apparent that DoD will be requiring an "affordability target" (in the vein of a Key Performance Parameter) that must be identified, maintained, and consistently analyzed in order for a program to progress through acquisition. To ensure affordability, the Department intends to continue the use of "will cost" figures to support budgeting and programming, but now also will require managers to demonstrate and justify what a program "should cost," and annually demonstrate to the Department that cost or value is improving.

Augmenting affordability, the Department plans to eliminate functional/mission redundancies among service programs and shorten acquisition timelines in an effort to reduce contract costs. The actions identified call for the Department to evaluate projects from a joint or department-wide perspective and ensure that proposed schedules are consistent with program requirements. In so doing, DoD believes it can better respond to war fighter needs by getting items to the battlefield quicker while filling mission-critical gaps through use of the joint arsenal versus service-specific programs or systems.

DoD Initiative: Incentivize Productivity & Innovation in Industry

Under the new guidance, defense contractors should expect to see an even greater increase in the Department's use of fixed-price contracts to control expenses and, perhaps, a willingness to pay a premium to obtain project financing with other than customary progress payments. The guidance directs the use of Fixed-Price Incentive

(Firm Target) ("FPIF") contracts as a "contracting officer's point of departure," where the use of a target cost, a target profit, and a price ceiling is appropriate. Under these contracts, the Department intends to use a 20% price ceiling as a starting point on its liability for target cost overruns and suggests that programs anticipated to have lower than a 120% price ceiling may suggest the need for a firm fixed-price contract. The Department reasons that, with a recent trend of flat defense budgets, any programs incurring costs above the 20% ceiling should be reviewed for cancellation. The Department also believes that the government's status as an "exceptionally reliable customer" may warrant a premium on payment arrangements outside of the customary progress payments. Accordingly, contracting officers are now required to identify the "consideration" offered by contractors for alternate payment structures after a fixed price has been negotiated.

Incentives under the initiative will be tied to performance and a contractor's ability to manage supply chain and indirect expenses. On a broad scale, the Department directed that a "Preferred Supplier Program," currently in use by the Navy, be expanded to include all services. This program will track contractors and reward "superior performance" with postaward special terms and conditions. Additionally, the Department will examine the reward and incentive strategies behind program profit policies to ensure that the planned profit is appropriate. The Department intends to take a recurring, performance-based approach in examining a program's profit policy and cites to aggressive subcontractor cost management and/or subcontracting breakouts, as methods by which contractors can control costs, lower expenses and be rewarded.

DoD Initiative: Promote Real Competition

The Department's guidance intends to "harness the full energy of competition" at every stage of the acquisition process, even if it is not organically present in the process. Accordingly, contractors now should expect negotiations with every competitive bid. The Department notes that failing to perform cost analysis and/or negotiations after receiving a single response to competitive solicitations has become a "common practice" that must stop. The Department "expect[s] contracting officers to conduct negotiations with all single bid offerors and that the basis of that negotiation shall be cost or price analysis, as the case may be, using non-certified data." *See* Redefining Cost Or Pricing Data. Additionally, in the absence of any of the "classic head-to-head competition," program managers are now directed to be creative in developing a competitive strategy for each program, citing to the use of open systems architectures, examining partial substitutes, adapting commercial products, and the breakout of subcontractors as methods to incite competition.

In regard to competition surrounding service contracts and multiple award IDIQ contracts, contractors should expect more frequent re-competes and contract durations that are "appropriate for the activity performed" (*i.e.*, longer for knowledge services, shorter for environmental remediation). Additionally, in the absence of competition, expect the Department to re-advertise service contract proposals when only one bid is received.

To ensure the presence and performance of competition, the Department also directs the services' competition advocates to develop a plan for improving the rate of competition on all contracts service-wide. Citing to an Air Force review for effective competition of its Design and Engineering Support Program, the Department recognized that the Air Force was able to reduce single-bid offers by 50% and increase competition in its IDIQ task orders by changing its source selection methodology and informing IDIQ holders of upcoming requirements. The Department expects competition advocates to seek similar results.

DoD Initiative: Improve Tradecraft in Services Acquisition

Recognizing that the practices surrounding buying services are "much less mature than for buying weapons systems," the most significant changes being proposed in the Department's guidance are related to the services contracts that make up 50% of DoD's contract spending. To better manage these contracts, each military service is directed to establish a Senior Manager for Acquisition of Services who will oversee the "planning, execution, strategic sourcing and management" of service contracts. These managers also will be responsible for ensuring the use of standard templates, with a common taxonomy, to define service contract requirements and spending department-wide.

When new services are contracted in the absence of competition, contractors now should expect the Department to employ a Cost Plus Fixed-Fee or Cost Plus Incentive-Fee arrangement until a baseline can be established. However, where past performance or competition exists related to the services being sought (or with multiple award contracts), the Department likely will seek services under a Firm Fixed-Price arrangement. Additionally, should the services sought be valued at over $1 billion, expect to see contract provisions intended "to achieve productivity improvements and cost efficiencies throughout the contract period."

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Be it a result of Departmental introspection or Congressional requirement, the Department of Defense clearly has adopted a New [Fiscal] Year Resolution: get fit and stay trim. It is now incumbent on defense contractors to stay flexible and make sure that they are able to keep-up with a leaner DoD or risk, themselves, becoming the biggest loser.