

COUNCIL OF DEFENSE AND SPACE INDUSTRY ASSOCIATIONS
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May 2, 2011

Ms. Amy Williams
OUSD (AT&L) DPAP/DARS
3060 Defense Pentagon
Room 3B855
Washington, DC 20301-3060

Subject: DFARS Case 2011-D010, Increase the Use of Fixed-Price Incentive (Firm Target) Contracts
CODSIA Case 04-11

Dear Ms. Williams:

The undersigned members of the Council of Defense and Space Industry Associations (CODSIA) appreciate the opportunity to comment on the proposed rule entitled "Increase the Use of Fixed Price Incentive (Firm Target) Contracts" that was published in the Federal Register on March 2, 2011. The proposed rule is in response to Under Secretary of Defense (Acquisition, Technology and Logistics) (USD/AT&L) memorandum of November 3, 2010 providing guidance on obtaining greater efficiency and productivity in defense spending.

The proposed DFARS rule directs contracting officers to "give particular consideration to the use of fixed price incentive (firm target) contract, especially for acquisitions moving from development to production." We are concerned that the proposed DFARS language, given the direction provided by USD/AT&L memorandum, will compel contracting officers to use FPIF contracts in inappropriate situations. Industry is already seeing inconsistent and contradictory application of Secretary Carter's principles in proposals, superseding existing FAR guidance without the benefit of a public comment period. Examples of this include several instances of contracting officers requiring that FFP contracts be converted to FPIF to satisfy what they believe to be direction to move to FPIF as well as the use of FPIF in early development. This abuse of existing FAR guidance in proposals by prematurely inserting Secretary Carter's principles in requirements will result in poor contract execution, more cost performance risks, and increased resources, resulting in a breakdown of Dr. Carter's goals.

We do not believe the proposed DFARS language is necessary, given the existing guidance provided at FAR Part 16.1 "Selecting Contract Types". FAR Part 16.1 provides contracting officers sufficient information for contracting officer's actions required to determine the proper contract type for the requirement. For example:

- FAR 16.104 address the factors to use in determining the contract type. It is unclear how the proposed direction fits with the existing direction for contracting officers to consider the 11 factors in 16.104. It would appear the DRS is now suggesting contracting officers no longer need to consider those factors and should instead, give "particular consideration to the use of fixed price incentive contracts."
- FAR 16.403-1 describes when an Incentive Contract is applicable - no further guidance is needed.

The proposed DFARS change would unduly influence Contracting Officers to use a FPIF contract type, without adherence to the principles outlined in FAR Part 16.1.

We also believe that the decision to choose fixed price incentive (firm target) contract types for late development or early production contracts could have a significant adverse impact on a company's working capital. An example of that impact is shown in the attached paper. Increases to working capital balances will have a detrimental effect for both industry and the government with the impacts becoming visible in reduced capital dollars being available for capital improvements, reduced dollars being available for application to IR&D initiatives, and higher costs associated with reduced working capital to sustain on-going operations. Each of these impacts are envisioned to have long term implications to the industrial base which in turn will impede industry's ability to support the government in a manner that is currently expected.

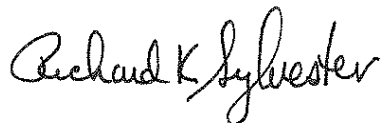
We do not believe the intent of the Under Secretary's memorandum was to create a major shift in working capital investment levels, but rather to establish better controls over contract price. If this proposed rule becomes final as written, we recommend adding FPIF as a contract type eligible for interim cost billings.

Allowing interim cost billings by the Department of Defense would achieve the price control sought by senior leadership without positively or negatively impacting working capital investments required. Our recommendations on the proposed DFARS rule attempts to equitably balance the increased technical, schedule, and **cost** risks assumed by the contractor under FPIF contracts with a financing option that would be more appropriate for the late-development and early-production efforts targeted by the new Department of Defense pricing strategy.

If the Defense Acquisition Regulations Council decides to go forward with a final rule, we do not believe that such a rule will accomplish the stated purpose of incentivizing productivity and innovation in Industry. In particular, the "default" arrangement of a 50/50 share ratio and 120 percent ceiling does not always provide for the best pricing solution. Each procurement is different and must be evaluated on its own merits. The Government should provide adequate training to Contracting Officers as to how the costs and share ratios should be established based on the risks inherent in the particular contract. CODSIA members do not believe that solicitations should specify the FPIF arrangement, but rather enable the offeror to propose the arrangement that provides the best incentive for contract performance. Accordingly, the default position should be removed from the proposed rule at 216.403-(b)(2).

If you have any questions, please contact the CODSIA project officer, Richard Sylvester, Vice President, Acquisition Policy, AIA, at 703-358-1045 or Bettie McCarthy, Administrative Officer, CODSIA, at 703-875-8059.

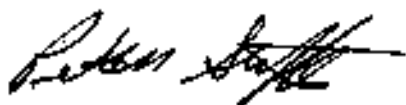
Sincerely,



Richard Sylvester
Vice President, Acquisition Policy
Aerospace Industries Association



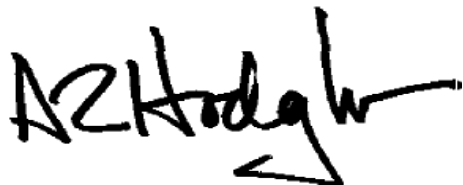
Richard L. Corrigan
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National Defense Industrial Association



Alan Chvotkin
Executive Vice President & Counsel
Professional Services Council



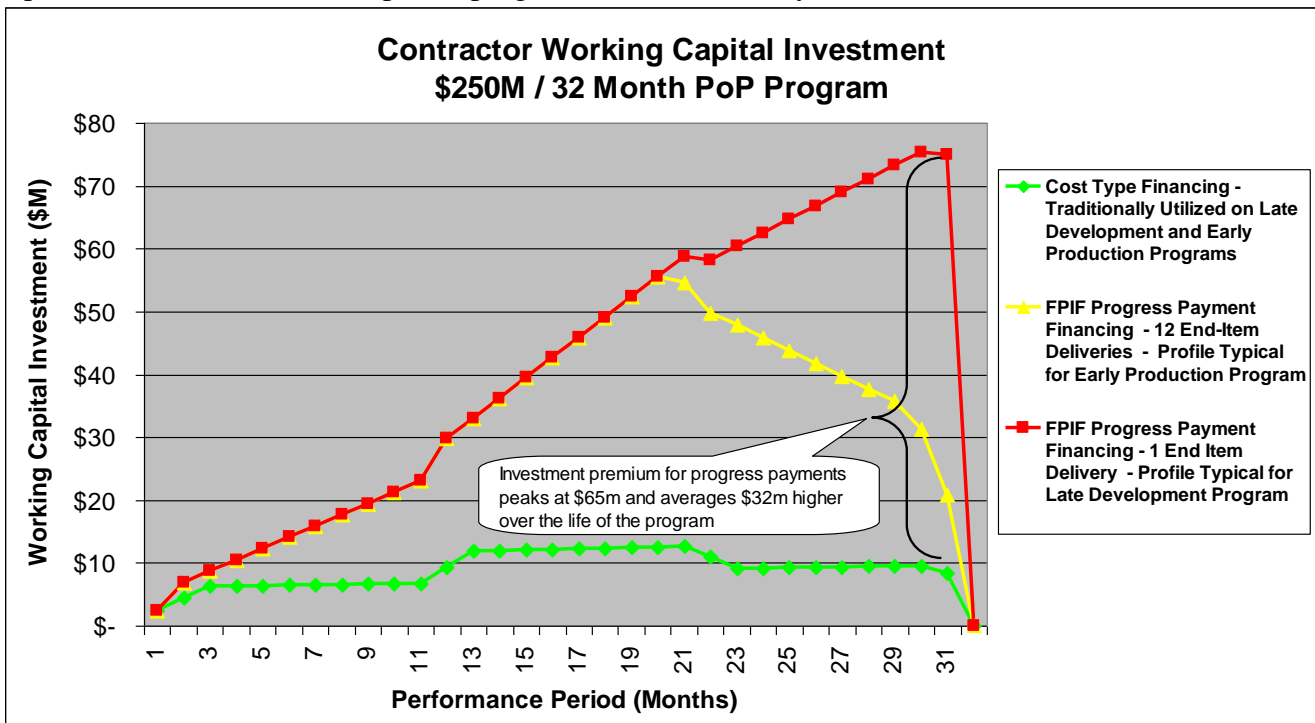
A.R. "Trey" Hodgkins, III
Senior Vice President, National Security and
Procurement Policy
TechAmerica

Attachment

FPIF Contracting – Ashton Carter Directive
Working Capital Impact and Options

In mid September Under-Secretary of Defense Ashton Carter issued a memorandum to all acquisition professionals on improving the efficiency and productivity in Defense spending. The memorandum has far reaching implications in many areas of the acquisition process. This paper will focus solely on the direction in the memorandum to increase the use of Fixed-Price Incentive Firm Target (FPIF) contracts in lieu of cost-type contracts (CPAF/CPIF) in late-development or early-production efforts. The paper discusses a major unintended consequence of the memorandum and presents an option to eliminate the risk the directive currently imposes on contractors. This paper will not challenge the decision to choose FPIF contracting over CPAF/CPIF in late-development or early-production efforts as a tool to control price, but rather on the significant adverse impact the decision will have on working capital.

Under the current Federal Acquisition Regulation, contractors are eligible to recover essentially 100% of incurred cost and billable fee every other week on cost type programs. Under Fixed Price Incentive programs, contractors recover 80% of incurred cost and no profit on a monthly basis prior to the point when deliveries commence. The chart below illustrates the required working capital investment a contractor would need to perform on a \$250 million, 32 month long, early production contract. In the example, working capital is defined as the unbilled cost and fee, as well as the billed but uncollected cost and fee that is on the contractor’s books at month-end. The expenditure profile by month used to calculate the working capital balances represents that of a typical major weapon system program. The green line plots the investment required, assuming the contract received cost type financing. The yellow and red lines plot the investment required assuming an FPIF award financed by progress payments. The difference between the two FPIF models is that the yellow line assumes twelve deliveries which are typical for early production programs and the red line is representative of a late development program with one delivery at the end of the contract.



In the example above, the required working capital investment to perform averages \$9.7 million for the cost scenario, and between \$33 and \$42 million for the two FPIF scenarios. At peak the FPIF options require between \$44 and \$65 million more working capital than if the effort was awarded

as a cost type program. When extrapolated to the entire industry the shift to FPIF progress payment financing has the potential to **increase working capital balances by over ten billion dollars** in an industry that is facing substantial financial challenges in the foreseeable future. A ten billion dollar hit to industry's balance sheet would not be well received in the financial market-place responsible for providing the additional liquidity required by contractors to perform on Department of Defense contracts. The increased investment required will also discourage new businesses from competing in the market-place and reduce the number of businesses willing to serve as primes.

We do not believe the intent of the memorandum was to create a major shift in working capital investment levels, but rather to establish better controls over contract price. If the later is the case, the unanticipated impact could be eliminated in the near-term with the issuance of a class-deviation by the Director of Defense Procurement and Acquisition Policy to permit the same type of financing provided for cost type programs (*bi-weekly interim billings*) on late-development or early-production FPIF programs. The deviation would simply add FPIF as a contract type eligible for interim billings in FAR 16.307(a) (1) (*Clause 52.216-7 Allowable Cost and Payment*). In the long-term the FAR should be modified to formally add late-development or early-production FPIF efforts to the list of contract types eligible for bi-weekly interim cost billings.

Other options to minimize the adverse working capital impact include the authorization of progress payment rates above the statutory level (recommend 99% rates and bi-weekly billings), or the use of performance based payment financing, both of which should be offered with no requirement for consideration as the financing provided would be less than under the cost type scenario. The performance based financing option in late development or early production efforts may not be suitable in many situations as even a minor performance issue has the potential to suspend contractor financing which in turn would place both contract performance and contractor's liquidity at risk. Another alternative would be the establishment of additional line items for various milestones that would allow earlier liquidation of progress payments. This could include line items under development programs for delivery of test assets, preliminary design review, critical design review, production readiness review, and long-lead material.

If the deviation and eventual FAR change to permit interim cost billings were implemented the Department of Defense would achieve the price control sought by senior leadership without positively or negatively impacting working capital investments required. The proposal above attempts to equitably balance the increased technical, schedule, and **cost** risks assumed by the contractor under FPIF contracts with a financing option that would be more appropriate for the late-development and early-production efforts targeted by the new Department of Defense pricing strategy.