Acquisition Reform Working Group

COMMENTS ON FY 2012 NATIONAL DEFENSE AUTHORIZATION ACT
HOUSE-PASSED H.R. 1540
AND
SENATE COMMITTEE-PASSED S. 1253

SEPTEMBER 19, 2011

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HOUSE SECTION 328 (H.R. 1540) – MODIFICATION OF REQUIREMENTS RELATING TO MINIMUM CAPITAL INVESTMENT FOR CERTAIN DEPOTS

DISCUSSION:
Section 328 would amend several subsections of section 2476 of title 10, United States Code, minimum capital investment for certain depots. The proposed changes in subsection (4) would expand the list of covered depots. ARWG recommends that section 2476 be limited to apply only to those depots that are covered by section 2474 of title 10, Centers of Industrial and Technical Excellence.

RECOMMENDATION:
ARWG recommends that subsection (4) be deleted from section 328.

HOUSE SECTION 802 (H.R. 1540) - REVISION TO LAW RELATING TO DISCLOSURES TO LITIGATION SUPPORT CONTRACTORS

Section 802 would amend title 10 by adding a new Section 129d that would authorize the Department of Defense to release sensitive information (i.e. confidential commercial, financial, or proprietary information, technical data, or other privileged information) to a litigation support contractor for the sole purpose of providing support during or in anticipation of litigation. A litigation support contractor to whom such information would be released would be required to acknowledge the sensitive nature of the information and take all precautions necessary to prevent unauthorized disclosure or use by the contractor to compete against a third party for government or non-government contracts. The penalty for violation would be the potential loss of the litigation support contract. This legislation was requested by the Department of Defense and would supersede the amendments to 10 U.S.C. 2320 enacted in section 801 of the Ike Skelton National Defense Authorization Act for Fiscal Year 2011 (P.L. 111-383).

DISCUSSION:

The Department of Defense justified the request for amended access authority for litigation support contractors (LSC) by reference to the fact that the existing authority in Section 801 of the FY11 NDAA was interpreted as only allowing access to technical data subject to license rights. According to DoD, LSC's needed access to much broader categories of sensitive data in order to adequately support ongoing litigation. Section 802 would effectively shield DoD employees from the liability associated with the release of the data.

While recognizing the potential need for LSC's to have access to a broader range of information than provided for in existing statute, ARWG is very concerned that the protection for unauthorized use of such information by an LSC is inadequate. Under Section 802, the only penalty faced by an LSC breaking its obligation is the potential loss of a contract. There are no further sanctions for unauthorized release or use of information after a contract is terminated.

RECOMMENDATION:

Because of its inadequate safeguards against the unauthorized use or release of sensitive information, ARWG strongly opposes Section 802 in its current form. At a minimum, the safeguards against unauthorized release or use required for sensitive information provided to government support contractors in 10 U.S.C. 2320(f)[1] (incorporated in the FAR through an

[1] 10 U.S.C. 2320: `(f) In this section, the term `covered Government support contractor' means a contractor under a contract the primary purpose of which is to furnish independent and impartial advice or technical assistance directly to the Government in support of the Government's management and oversight of a program or effort (rather than to directly furnish an end item or service to accomplish a program or effort), which contractor--
`(1) is not affiliated with the prime contractor or a first-tier subcontractor on the program or effort, or with any direct competitor of such prime contractor or any such first-tier subcontractor in furnishing end items or services of the type developed or produced on the program or effort; and
`(2) executes a contract with the Government agreeing to and acknowledging--
`(A) that proprietary or nonpublic technical data furnished will be accessed and used only for the purposes stated in that contract;
`(B) that the covered Government support contractor will enter into a non-disclosure agreement with the contractor to whom the rights to the technical data belong;
`(C) that the covered Government support contractor will take all reasonable steps to protect the proprietary and nonpublic nature of the technical data furnished to the covered Government support contractor during the

interim rule published on March 2, 2011) should be applied in appropriately tailored form to the sensitive information proposed to be provided in section 802.

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program or effort for the period of time in which the Government is restricted from disclosing the technical data outside of the Government;

`(D) that a breach of that contract by the covered Government support contractor with regard to a third party's ownership or rights in such technical data may subject the covered Government support contractor--

`(i) to criminal, civil, administrative, and contractual actions in law and equity for penalties, damages, and other appropriate remedies by the United States; and

`(ii) to civil actions for damages and other appropriate remedies by the contractor or subcontractor whose technical data is affected by the breach; and

`(E) that such technical data provided to the covered Government support contractor under the authority of this section shall not be used by the covered Government support contractor to compete against the third party for Government or non-Government contracts.'.

HOUSE SECTION 803 (H.R. 1540) - EXTENSION OF APPLICABILITY OF THE SENIOR EXECUTIVE BENCHMARK COMPENSATION AMOUNT FOR PURPOSES OF ALLOWABLE COST LIMITATION UNDER DEFENSE CONTRACTS

SENATE SECTION 842 (S. 1253) - EXTENSION TO ALL MANAGEMENT EMPLOYEES OF APPLICABILITY OF THE SENIOR EXECUTIVE BENCHMARK COMPENSATION AMOUNT FOR PURPOSES OF ALLOWABLE COST LIMITATIONS UNDER GOVERNMENT CONTRACTS

Section 803 of H.R. 1540 would amend the limitation on the allowability of the cost of senior executive compensation in 10 U.S.C. 2324(e)(1). The Office of Federal Procurement Policy (OFPP) cap on allowability of compensation is currently $693,951, and it is limited to the 5 highest paid management employees of the contractor. This change would extend the allowability cap to compensation of all employees. Compensation includes total amount of wages, salary, bonuses, and deferred compensation for the year. The compensation allowability level is calculated annually by the Administrator of OFPP using methodology in 41 U.S.C. 435. Section 803 would not alter either the definition of compensation or the methodology for calculating the annual cap. The expanded coverage of employee compensation would be effective for any cost incurred after January 1, 2012 under all current and future contracts.

This legislative provision was requested by the Department of Defense. Neither the Department of Defense nor the Congressional Budget Office scored any savings through the implementation of this provision.

The Senate included section 842 in S. 1253 reported by the Senate Armed Services Committee that would extend the cap in a similar fashion to all *executives* in a corporation (but not to all employees as does H.R. 1540).

DISCUSSION:
Congress enacted the current legislation capping allowability of senior executive compensation costs as section 808 of the National Defense Authorization Act for Fiscal Year 1998. The motivation for the current law was the concern that what might be considered reasonable senior executive compensation under federal contracts could be significantly higher than that received by the President of the United States or the Secretary of Defense. Although the passage of 10 U.S.C. 2324 settled the issue of setting a reasonableness standard for the allowability of compensation for the top five most senior executives under government contracts, the limitation to a relatively small number of individuals in each company limited the impact and undercut the need to examine a number of general policy issues with respect to executive compensation in the private sector and the relationship to public sector compensation practices.

Executive compensation levels in private corporations are not set in a vacuum, but are the result of the use of a number of compensation surveys and benchmark studies that are applicable to both contractors that are government and non-government suppliers. These surveys and other tools allow corporate boards of directors and other officials to set total compensation levels in a manner that allows corporations to effectively compete with their peers for emerging management talent and business opportunities. Similarly, the various non-salary elements of

executive compensation, such as bonuses or deferred compensation are limited by corporate earnings and the need to preserve a strong balance sheet for the financial and equity markets. The justification for expanding the coverage of the compensation cap provided by the Department of Defense does not reflect any of this understanding and only points to the desire to eliminate the "risk of reimbursing contractors for excessive compensation" and the desire to eliminate the application of the cap for only the top five senior executives in a given corporate or division headquarters. No further fact-based analysis is offered to support the Department of Defense proposal nor is there an assessment of the potential impact on government contractors. This issue, at a minimum, deserves further study before enactment of a more sweeping change.

RECOMMENDATION:

Because of the lack of an impact analysis of expanding the current cap on compensation allowability, ARWG recommends that the conferees adopt the approach in Senate section 842 and clarify that the cap should only cover senior executives with profit and loss responsibilities. This would eliminate the arbitrary cut-off in current law covering the top five executives at each headquarters but allow time for further analysis before considering extending the cap more broadly. The conferees should further consider clarifying the definition of "senior executive" to read:

> "The term "senior executives", with respect to a contractor, means employees serving in general management positions at each home office and each segment of the contractor with responsibilities related to the corporate entity's profit and loss. The term specifically excludes all employees who do not manage the overall operations of the home office or segment; all employees who solely manage an engineering, program management, operations or other organizational element supporting a program; and all employees who do not otherwise supervise employees."

HOUSE SECTION 804 (H.R. 1540) - SUPPLIER RISK MANAGEMENT

Section 804 requires buyers in DoD to use a business credit reporting bureau to evaluate supplier risk on all contract actions. The section further requires DoD to track all suppliers, including subcontractors and sources of supply, without limitation, during the course of the contract using a commercial-off-the-shelf product for: debarments and suspensions, mergers and acquisitions, bankruptcy filings, criminal proceedings against a person or company, financial changes, or deterioration of a company.

DISCUSSION:

The government already has an arrangement with a credit reporting service, Dunn and Bradstreet (D&B) for the identification of companies. A D&B identification number is required for registration in the Centralized Contractor Registration (CCR) Database. The government is not required to use D&B to evaluate the credit worthiness (financial responsibility) of a company during the responsibility determination required under FAR Part 9 before a contract award is made. If the government has a question about the financial responsibility of an offeror, the government may request a pre-award audit from the Defense Contract Management Agency.

ARWG reminds the Committee that Congress provided guidance to DoD in the Report Language (#109-254 – Items of Special Interest) that accompanied S. 2766 to the effect that:

> "The committee does not believe that it is appropriate to require potential contractors to pay third parties for the right to bid on federal contracts. Moreover, any past performance evaluation conducted for or on behalf of a federal agency must comply both with the requirements of section 6 of the Office of Federal Procurement Policy Act (41 U.S.C. 405) and subpart 42.15 of the FAR. The committee directs the Under Secretary of Defense for Acquisition, Technology, and Logistics to provide guidance to the military departments and defense agencies on the appropriate means of evaluating and considering past performance information, including the appropriate use, if any, of third party performance evaluation reports."

The government does not have a responsibility to determine the financial responsibility of subcontractors; that is the responsibility of the prime contractor and forms a portion of the fee paid the prime for managing its subcontractors. Further, if the subcontractor fails to perform, for any reason, the liability and responsibility falls to the prime contractor under the current process to remedy the situation at no cost to the government. The relationship between the prime contractor and subcontractor is referred to in the law as "privity." The same can be said of the relationship between the government and the prime.

The government has steadfastly refused, since the end of World War II, to interfere with the privity of contract between a prime contractor and subcontractor. A primary reason is that interference of the government between the prime contractor and the subcontractor can result in the creation of privity between the government and the subcontractor and substitute the government for the prime in that relationship for liability purposes, among other things. This section as drafted would interfere with the privity between the prime contractor and the subcontractor.

Further, absent explicit implementation guidance, it is most likely that the government, as it has in the past, shift the burden for collecting the data on subcontractors to the prime contractor—some prime contractors have a great many subcontractors—as it has for example in the creation of eSRS. Such a shift in burden will add overhead costs to the prime contractor which will ultimately be passed along to the government in the form of higher prices. It also runs the risk of collecting redundant data since many prime contractors share some of the same subcontractors and many prime contractors are themselves subcontractors.

Finally, since the government, in most contracts, pays the prime contractor to manage the subcontractors the prime chooses, this section will cause the government to pay twice for the same service, also increasing costs that the taxpayer will ultimately pay. The better approach would be to require the government to carefully measure a prime contractor's management of its subcontractors through both performance evaluation and award fee.

RECOMMENDATION:
ARWG recommends subsection 804(c) be stricken in its entirety and replaced with the following language:

> "(c) The Secretary of Defense shall, through appropriate changes to the Defense Federal Acquisition Regulation Supplement, require management of prime contractors in the area of subcontractor management in performance evaluations required in FAR Part 42.15.
>
> The regulations shall permit the use of award fee to incentivize excellent supply chain risk management and shall be permitted to roll over from one award fee period to another in the discretion of the fee determining officer."

HOUSE SECTION 806 (H.R. 1540) - DEFENSE CONTRACT AUDIT AGENCY ANNUAL REPORT

DISCUSSION:
This section would require the director of DCAA to submit an annual report that summarizes DCAA's audit activities during the previous fiscal year, including significant problems, abuses, and deficiencies, a statistical table showing the total number of audit reports, the length of time taken for each audit, and the questioned dollar value, as well as recommendations for corrective actions. The report also would include a summary of any backlog of pending contractor audits and a rationale for the cause of the backlog. The annual report would be required to be provided to the congressional defense committees by March 30 of each year and to be made available on a public website within 60 days after receipt of the report by Congress.

In addition to Section 806, the committee report for H.R. 1540 includes language expressing the committee's concern with DCAA audit backlogs and their negative impact on the acquisition process. According to the committee, such delays not only impact the government's ability to recoup monies owed to it, but also limit competition by restricting the ability of companies to participate in the federal contracting process, despite the fact that they may have addressed deficiencies identified in a DCAA audit. The committee report language directs DCAA to review the decision to eliminate the use of inadequate-in-part findings in favor of instituting a pass-fail standard, and to make recommendations for improvements in the timeliness of the evaluation and the re-evaluation of contractor business systems.

ARWG believes that Section 806 and the committee report language are positive steps that can provide increased understanding of the challenges facing DCAA and may spur reforms that will allow DCAA to meet its mission effectively and efficiently. However, ARWG is concerned that information about audit findings that are not final could be included in the report required by Section 806. Including such information in the report could lead to assumptions and future legislative proposals that are not based on finally determined audit findings. ARWG is also concerned that company proprietary information, or information identifying specific companies could be included any publicly available report.

RECOMMENDATION:
ARWG generally supports Section 806 and the DCAA committee report language. However, ARWG encourages Congress to clarify to DCAA that the report required by this section should only include information about audit findings that are final and any public report should not include any company identifying or proprietary information. Additionally, ARWG encourages Congress to request other information in the required report that would further help the armed services committees evaluate DCAA. Such information should include:

- A general overview of how corrective actions were implemented and how the input of contracting officers and stakeholders were sought, processed, and incorporated into the audit process.
- Identification of risk with assessments showing probability of occurrence, dollar impacts, and timing (severity of risk).
- Methods used to ensure compliance with GAGAS, including peer quality and external assessments.

- Identify backlog and plan for prioritization and completion.
- Measurement and summary of timeliness for requisite follow-up.
- Compilation of materiality considerations brought forward to audit managers, i.e. cost benefit analysis.
- Real cost savings in terms of cost recommendations sustained by the contracting officer.
- Overall summary of additional recommendations of actions or resources needed to improve the audit process.

HOUSE SECTION 821 (H.R. 1540) - RESTRICTIONS ON AWARDING CONTRACTS IN SUPPORT OF CONTINGENCY OPERATIONS IN IRAQ OR AFGHANISTAN TO ADVERSE ENTITIES

DISCUSSION:
This section would allow the Secretary of Defense to void a contract or task or delivery order that has been awarded if the secretary determines that a foreign entity or foreign individual performing on the contract is directly engaged in hostilities. The application of the section flows down to the subcontract level whereby the secretary can require the prime contractor to void any subcontracts where it is determined that a subcontractor is directly engaged in hostilities.

ARWG supports the intent of this provision and strongly believes that DoD should be provided flexibility to ensure that U.S. dollars are not flowing to terrorists. However, as currently written, this section could authorize DoD to void contracts in instances where a prime contractor may have subcontractors funneling support to adverse entities without any knowledge by the prime contractor that such activity is taking place. ARWG does not believe the intent of the legislation is to punish prime contractors for such instances. Hence, the language should be revised to clearly state that prime contracts should not be voided in instances where subcontractors have been found to have violated the prohibition on supporting adverse entities, provided that the prime contractor had no knowledge of the infraction and is taking appropriate action, as directed by the secretary, to eliminate the flow of U.S. funds to the subcontractor.

In addition, it is feasible that a prime contractor could have an employee who is funneling support to adverse entities without any knowledge of such activity by the company's leadership. The U.S. government's "Afghan First" policy, which encourages contracting with Afghanistan companies, and the difficulty in firms' ability to have transparency into all the financial and non-work related activities of its employees makes it likely that contractor employees could be supporting adverse activities without knowledge of the company. Where such instances have been found to have occurred, the secretary should be given the flexibility not to void the contract if the company has taken appropriate action to remediate the situation, e.g. fired the employee.

This section is also unclear about how prime contractors would be reimbursed for expended funds to subcontractors that are supporting adverse entities. For example, in many instances, prime contractors expend funds on subcontractors with the understanding that they will later be reimbursed by the government for incurred costs. If, in the meantime, the subcontractor is discovered to be supporting adverse entities and the prime contractor is directed to void the contract with the subcontractor, it is likely that the prime contractor would NOT be reimbursed for any funds that were incurred or paid in good faith to the subcontractor. To avoid unfairly penalizing prime contractors or higher tier subcontractors that have no way knowing that one of their subcontractors was funneling support to adverse entities, the language should clarify that prime contractors or higher tier subcontractors will be reimbursed for expended funds in instances where they have already paid the subcontractor and had no knowledge that the subcontractor was funneling funds to adverse entities.

Section 821 fails to recognize a number of other actions that the secretary may take in instances where companies have been found to have violated this section. For example, in lieu of voiding contracts and subcontracts, the secretary should be given the flexibility to enter into other

administrative agreements that more appropriately address the severity and specific details of the violations.

Lastly, DoD and USAID have undertaken initiatives to vet non-U.S. vendors in Afghanistan prior to and after contract award to ensure that contract funds are not being used to fund adverse activities. Such efforts to protect against misuse of U.S. funds should be supported and to the maximum extent practicable, these efforts should focus on pre-award efforts to vet contractors. A GAO report issued on June 8, 2011 expressed concern that vetting efforts might be under-resourced and that USAID and DoD formalize procedures to increase collaboration for contractor vetting.

RECOMMENDATION:
ARWG recommends this section be amended to clarify that prime contracts shall not be punished if one of their employees or subcontractor is funneling support to adverse entities and the prime contractor had no way of knowing about it and took appropriate action upon learning of the infraction. In addition, prime contractors that had no way of knowing one of their subcontractors was funneling support to adverse entities should still be eligible to be reimbursed for any legitimate payments to such subcontractors that the prime contractor has already paid. The secretary should also be given leeway to rely on other mechanisms for addressing violations of this section, and should not be forced into a binary decision to void or not void a contract or subcontract. Lastly, ARWG encourages Congress to ensure that federal agencies are appropriately resourced and are working collaboratively on non-U.S. vendor vetting efforts. Furthermore, in instances where the U.S. government has undertaken vetting initiatives, the results should be made available to contractors so that they can rely on the information to help them make informed decisions about who they may or may not contract with. When contractors rely on the vetting information provided by the U.S. government, they should be afforded a safe harbor from penalties unless they knowingly contract with adverse entities.

HOUSE SECTIONS 823 AND 824 (H.R. 1540) - AUTHORITY TO EXAMINE RECORDS OF FOREIGN CONTRACTORS PERFORMING CONTRACTS IN SUPPORT OF CONTINGENCY OPERATIONS IN IRAQ OR AFGHANISTAN

DISCUSSION: Section 823 would require the Secretary of Defense to develop and issue guidance that would allow the secretary to examine the records of a foreign contractor, or a foreign subcontractor, performing on a contract in support of contingency operations in Iraq or Afghanistan. This authority would not apply if the contract was being performed by a contractor or a subcontractor that is a foreign government, or agency of a foreign government, or if precluded by applicable laws.

Section 824 defines certain terms related to Section 823 including "contract in support of a contingency operation in Iraq or Afghanistan," "contingency operation," "records" and "foreign contractor."

Even with the definitions provided in Section 824, the language in these provisions is extremely vague and provides no details regarding the procedures that are to be followed in obtaining such records, what (if any) limitations should be adopted through the implementation of the guidance, or what recourse the contractor may have to protect its intellectual property or business sensitive data. Presumably, these issues would be determined through DoD's implementing regulations, but the legislative language provides little direction as to how DoD should proceed with the implementation.

RECOMMENDATION:
ARWG recommends that the language be clarified to adequately describe the rationale for this provision, the information involved, and specific steps for implementation as it relates to contractors' and DoD's responsibilities under the legislation and any implementing regulations. ARWG also recommends that the language be modified to direct the secretary to implement the guidance in accordance with 10 U.S.C. 2313, titled "Examination of Records of Contractor," that governs access to records for U.S. contractors. Lastly, implementation of these requirements and the regulatory guidance should specifically require DoD to publish its guidance for public comment and permit an adequate phase-in period for compliance.

HOUSE SECTION 825 (H.R. 1540) - QUALITY ASSURANCE SURVEILLANCE PLAN FOR SECURITY CONTRACTORS

DISCUSSION:

Section 825 requires the Secretary of Defense to establish a plan, to be known as the "Quality Assurance Surveillance Plan," setting standards that must be incorporated into DoD oversight plans governing all security contractors operating in Afghanistan, and other future contingency operations, under a contract or subcontract funded by DoD. The Secretary shall designate a single official stationed in the country of operations to review each security contract or subcontract involving security contractors for compliance with the plan. Such official shall certify that the official has taken specified actions. These requirements shall be implemented not later than six months after enactment. Six months after these requirements are implemented, GAO is to conduct an assessment of the department's compliance with the requirements of this section and submit a report to Congress.

Under current law, performance-based service contracts are required to have a Quality Assurance Surveillance Plan (QASP).[1] However, this legislative provision imposes an obligation on the department to establish a different type of plan than is traditionally understood to be a "QASP," even for contracts for security. In addition, existing statutory and regulatory requirements already impose a wide range of specific obligations on security contractors supporting DoD missions.[2] Furthermore, DoD guidance already requires DoD's contracting officers to incorporate into their acquisition plans detailed information on how private security companies are to be used in support of contingency and reconstruction operations.[3]

ARWG welcomes the department developing a uniform set of standards that are to be incorporated into DoD oversight plans relating to security contractors and, as part of that plan, ensuring that an appropriate number of trained personnel are available to oversee each security contract. To the extent that the oversight plan also provides for a confirmation that a security services contractor and its employees have all appropriate licenses, that element duplicates the contractual requirements already imposed on such contractors and that are reviewable by the cognizant administrative contracting officer assigned to that contract.

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[1] See generally Federal Acquisition Regulation (FAR) Part 46.4, "Government Contract Quality Assurance"

[2] For example, in Section 862 of the FY2008 NDAA (P.L. 110-181) Congress required the Secretary of Defense, in coordination with the Secretary of State, to prescribe regulations and guidance relating to screening, equipping, and managing private security personnel in areas of combat operations. These regulations are to include tracking private security personnel (PSC), authorizing and accounting for weapons used by PSCs, and reporting requirements whenever a security contractor discharges a weapon, kills or injures another person, or is killed or injured. In addition, Section 861 of that same NDAA required DOD, State and USAID to sign a memorandum of understanding governing how to track contracts and contractor personnel in Iraq and Afghanistan. Finally, FAR 52.225-19 governs contracts Contractor Personnel in a Designated Operational Area or Supporting a Diplomatic or Consular Mission Outside the United States, while DoD FAR Supplement (DFARS) 252.225-7004 implements DoD policy regarding contractor personnel authorized to accompany U.S. Armed Forces deployed outside the United States.

[3] See DoD Instruction 3020.41

RECOMMENDATION:
ARWG recognizes that most of the requirements of this section are already covered in existing regulations imposed on security contractors or part of existing DoD guidance to its own workforce. Integrating this information into a single oversight plan may be useful. As such, ARWG does not oppose the provision in its current form. However, ARWG recommends that potential ambiguities in the provision be eliminated through a careful redraft of the section's requirements.

HOUSE SUBTITLE D, SECTIONS 831-835 (H.R. 1540) - DEFENSE INDUSTRIAL BASE MATTERS AND RELATED INDUSTRIAL BASE PROVISIONS

Subtitle D (Sections 831-835) continues the process of more closely examining the fragility of the defense industrial base. The Fiscal Year 2011 National Defense Authorization Act (P.L. 111-383) included a number of important provisions related to the industrial base, including a prohibition on using goals or quotas for insourcing; a requirement for DoD to establish a program to expand the defense industrial base to include nontraditional suppliers and firms located near installations; a requirement to review and recommend elimination of barriers to contracting with DoD; expanded inclusion of providers of services and information technology in the National Technology and Industrial Base, laying the foundation for sustainment as an industrial base strategy; and establishing a Deputy Assistant Secretary of Defense for Manufacturing and Industrial Base Policy. Sections 831-835 would continue this focus by examining manufacturing risk, competition, physical risk from attack, and supply disruptions.

DISCUSSION:

The Department of Defense is the world's premier consumer of modern military equipment, virtually all of which is manufactured by private industry. The knowledge and production lines within America's private sector defense industrial base related to design, development, production and support is critical to our nation's ability to convert U.S. technological capabilities into superior military applications. Industry's specialized knowledge and technical capacity is applied via unique systems engineering and integration capabilities to convert technologies first into systems and then into systems-of-systems.

There are a number of challenges facing that part of the United States industrial base specialized to make available the critical equipment, components, subcomponents, and materials needed to support our current and long-term national military strategy. The greatest challenge is the absence of a clear Defense Department industrial policy capable of guiding and sustaining the defense industrial base. In recent years, Pentagon acquisition and budget policies have reduced the number of new defense systems sought. This has meant fewer new programs spaced further and further apart, resulting in a shrinking of the defense industrial base and an erosion of its ability to produce systems to respond to near and long-term contingencies.

This contraction and the prospects for further reductions have necessarily changed the behavior of the defense industry as a whole. Previously, investment decisions were predicated on the assumption that sufficient defense business would be available to justify outlays in research, facilities, and the training of personnel. Today, some defense firms are reluctant to continue to invest in plant, equipment, technology and the development of a skilled labor force for fear of losing their financial viability if programs are cut or eliminated. The loss of a single competition, or the elimination of a weapon system, could mean that a corporation is driven out of a line of business. Many critical components are available from only one supplier, whose viability increasingly depends on the next contract. Increasingly, this dynamic results in reduced competition at the prime level, where only two or three prime contractors are capable of competing for a contract.

Despite these challenges, the U.S. aerospace and defense industry continues to be the bedrock of U.S. economic and national security, as the single largest positive contributor to our nation's

trade balance and the provider of essential products and services that protect U.S. interests at home and abroad. However, our technological edge is increasingly challenged by both external and internal forces. China is making aggressive investments in building an indigenous aerospace and defense capability and securing technology, manufacturing capability and raw materials necessary to compete in the global defense market. Russia is working diligently to reconstitute its aerospace and defense industrial base, segments of which eroded substantially in the post-Cold War era. If we allow our own industry to languish by failing to change acquisition and other policies that impact the overall health of our defense industrial base, our technological edge and our nation's ability to respond quickly and effectively to new threats will be undermined.

RECOMMENDATIONS:
ARWG supports Sections 831- 835 because they stress the importance of ongoing attention to the defense industrial base. These proposals include general provisions as well as ones targeted at specific areas. Particularly with respect to proposals targeted at specific situations, such as rare earths or specialty metals, ARWG believes that it is important to have a clear policy objective to support the legislative proposals. The ability to implement these provisions as well as the cost are important factors in ensuring a strong industrial base. One example is the very carefully crafted approach in the existing specialty metals clause, and the importance of ensuring the benefits of that balanced approach is maintained.

We believe there are a number of additional tenets the government can adopt that will ensure it has the necessary access to essential products and skills from the defense industry for decades to come:

1. Communication- Congress and DoD need to communicate with each other about realistic Defense priorities and resource constraints along with an understanding of industry capabilities that impact cost and timeliness, and consider impacts on industry that can affect its long-term ability to support the national military strategy. With this information, industry can shape itself to meet the department's long-term needs at the most efficient level for the taxpayer.

2. Avoid Across-the-Board Cuts-Though advocated by various deficit-reduction study groups and some members of Congress, across-the-board cuts to the defense budget – versus targeted efforts to reduce spending in appropriate areas—would be detrimental to DoD, its industrial base and the nation's economic vitality. Congress and DoD need to ensure that DoD's shrinking resources go to the highest priority needs, while also considering medium and long-term needs. Without considering the whole picture, more unwelcome and more serious surprises will hamper our ability to support U.S. warfighters.

3. Investment - Keep Procurement and RDT&E consistent at 35 percent of the total DoD budget. In addition to external budget pressures, DoD's internal budget pressures, arising from increases in personnel and operational costs, threaten to undermine the modernization accounts that are critical to maintaining a healthy industrial base.

4. Predictability - Provide additional multi-year procurements in order to provide industry with the ability to make long-term industrial base decisions.

5. Performance - Increase the use of long-term performance and outcome-based contracts.

6. Planning - Congress should direct DoD to publish and maintain an industrial policy roadmap (which can guide Congress, DoD and industry through their respective decision making processes) that addresses the current and anticipated national security needs and ensures appropriate risk assessments are conducted related to potential supply-chain vulnerabilities.

HOUSE SECTION 845 (H.R. 1540) - PREFERENCE FOR POTENTIAL CONTRACTORS THAT CARRY OUT CERTAIN ACTIVITIES

Section 845 would create a preference to any offeror that promotes the science, technology, engineering, and math (STEM) disciplines. The sections identifies seven actions a contractor could perform to receive the preference: 1) enhance undergraduate, graduate, and doctoral programs in STEM; 2) invest in STEM programs within elementary and secondary schools; 3) encourage volunteers in Title 1 schools to enhance STEM education and programs; 4) make personnel available to advise college and university faculty; 5) establish partnerships with historically Black colleges and universities ("HBCUs") to train students in STEM; 6) award scholarships and internships to students in the STEM disciplines; 7) recruit students at HBCUs.

DISCUSSION:

ARWG opposes this provision. ARWG does not question the importance of science, technology, engineering and mathematic (STEM) education. The proposed legislation, however, could have the unintended consequence of benefiting large businesses over small businesses, would likely not improve or impact contractor's performance, and could create a new basis for contractor protests.

Science, technology, engineering and mathematics form the foundation and ensure the basic viability of many defense contractors. Without this creative scientific and mathematic workforce most defense contractors would cease to exist. Given the significance of the STEM disciplines, many of the larger defense contractors contribute significantly to STEM programs. Smaller contractors, however, may not have the financial resources to support STEM disciplines to the same extent as larger contractors. This provision, therefore, could give those larger contractors a competitive advantage over smaller businesses.

The requirement to support STEM activities, however, would not impact a contractor's ability to perform contract requirements quicker, better, or cheaper. Rather, it would simply add to the fog of the contracting process. The legislation does not identify which, or how many, of the seven actions a contractor could take to receive the preference. Adding a new preference could merely add a new basis for contract protests.

RECOMMENDATION:

ARWG recommends section 845 not be included in the Conference Report. The provision would cause unnecessary confusion to the contracting process; would not improve contractor performance; and would not increase contractors' support of STEM programs as contractors are already inherently incentivized to support STEM initiatives.

HOUSE SECTION 846 (H.R. 1540) - REPORTS ON USE OF INDEMNIFICATION AGREEMENTS

DISCUSSION:
Section 846 adds a new provision in title 10 that requires the Secretary of Defense, beginning October 1, 2011, to submit to the congressional defense committees a report within 90 days after entering into a new indemnification agreement or modifying an existing indemnification agreement in any contract, except for indemnification agreements entered into pursuant to either research and development contracts or the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA). Each report shall contain four specific matters identified in the provision. The Secretary may omit information in a report if disclosure is not in the national security interests of the U.S.

On November 24, 2010, Principal Deputy Under Secretary of Defense (AT&L) Frank Kendall responded to a written request from Congressmen Blumenauer (D-OR) and others for information on all indemnification agreements under DoD contracts. In his response, Mr. Kendall provided a list of all DoD indemnification agreements; only one indemnification agreement in place – with KBR relating to carry out their RIO contract in Iraq – was classified and would not be released.

Furthermore, any indemnification agreement entered into by a federal agency under Public Law 85-804 is already required to be submitted to Congress with information on the elements of the indemnification agreement. In addition, ARWG recognizes and supports the exclusion of indemnification agreements entered into under research and development contracts and CERCLA, as provided for under this provision.

RECOMMENDATION:
ARWG does not oppose this provision in its current form as it is unlikely that there will be more than a handful of non-traditional, contract-specific indemnification agreements entered into by the Defense Department and because the legislative provision already properly excludes those indemnification agreements entered into by DoD pursuant to research and development contracts and under CERCLA.

HOUSE SECTION 847/SENATE SECTION 845 - PROHIBITION ON COLLECTION AND DISCLOSURE OF POLITICAL CONTRIBUTIONS

House Section 847 would prohibit the requirement to disclose political contributions to contracting officials when a federal contractor submits a proposal to the federal government. A recent draft Executive Order (EO), "Disclosure of Political Spending by Government Contractors" would levy the requirement upon those bidding for government work that they disclose contributions and expenditures that they, their directors, officers, affiliates, subsidiaries—and presumably the directors and officers of those affiliates and subsidiaries—have made within the two years prior to submission of their offer to any federal candidate, party, or party committee and any third party entity that would use those contributions for communications during an election. The submission and accuracy of this disclosure would have to be certified by the company representative submitting the proposed bid. The House provision would prohibit the collection and disclosure of this information except in those circumstances where it is currently provided for by the Federal Election Campaign Act of 1971. Senate Section 847 would also prohibit the collection of such information with the exception of those circumstances where the collection is allowed by the Federal Election Campaign Act of 1971, the collection of such data by law enforcement or regulatory agencies, or the collection of such data by DCAA for audit purposes.

DISCUSSION:

As written, the EO would introduce political contributions into the government contracting process. It is unclear how the information would be used by a contracting officer in the source selection process. This creates the possibility that donations to a particular party or candidate will be a consideration when evaluating contract proposals, whether intended or not. This might also create the unfortunate belief among some that political contributions are a requirement for winning contracts.

The draft EO appears to ignore current law barring government contractors from making "any contribution of money or other things of value, or to promise expressly or impliedly to make any such contribution to any political party, committee or candidate for public office" from corporate funds[1]. In fact, it goes well beyond established law, requiring companies to report political contributions their officers and directors have legally made with their own personal funds, thus infringing on contractor employees' First Amendment rights.

Furthermore, current election law already requires that campaigns collect and report data on their donors—including their donors' employers. Today, if you want to know what political contributions have been made by the employees of any federal contractor, you can access a public database and simply type in a search by the employer name and get the results. Does providing this information to a procurement official make them any better informed on the merits of a proposal, or simply make them better informed on who has made political contributions to the administration or any other federal candidate?

In order to comply with this executive order, each federal contractor will have to develop and implement a system to track and record all personal political contributions, to include retroactive contributions upon implementation. This is an additional cost burden that will be reflected in

[1] 2 U.S.C. 441c, "Contributions by government contractors"

overhead rates. This is particularly challenging for small companies, such as those in the aerospace supplier base, who do not have a large corporate organization to meet this new federal mandate.

Furthermore, the certification requirement places an undue risk on small companies in the event that any of their directors, officers, affiliates, subsidiaries or the directors and officers of those affiliates and subsidiaries provide the contractor with inaccurate or incomplete information. If the company submission for the contract contains a list of donors that is incomplete, even though the company tried to fully comply, they may find themselves in an expensive legal proceeding for violation of Title 18 and Title 31 of the U.S. Code for making false claims or statements. Smaller companies that cannot afford to defend themselves in these situations may instead opt to avoid government contracts altogether.

This last point is not necessarily restricted to small companies. The imposition of a disclosure and certification requirement could also result in large and medium sized businesses opting out of selling to the federal government, potentially leaving the government without access to technologies and services necessary for its mission. Businesses are most likely to avoid federal contracting not because of concerns about transparency of political contributions but because of concerns about the burden of complying with the disclosure and certification requirement, as well as the consequences of inadvertent errors in reporting.

RECOMMENDATION:

Requirements already exist to ensure transparency of political contributions. Those requirements apply evenly across the board for all individuals and organizations that make political contributions. The EO would impose an undue, additional burden for duplicative reporting by federal contractors. The EO, if signed, would introduce politics into that arena and increase the regulatory burden and risk for companies. The amendment would ensure that this does not happen, keeping political considerations out of any decision a contracting officer makes in the award of federal contracts. The Senate exceptions for regulatory, law enforcement and auditing agencies might be mistakenly construed to allow the issuance of requirements to collect and distribute this information. Therefore, ARWG supports the adoption of the House provision.

HOUSE SECTION 931 (H.R. 1540) - GENERAL POLICY FOR TOTAL FORCE MANAGEMENT

DISCUSSION:
This section would require the Secretary of Defense to develop and implement a total force management plan that would determine the appropriate manpower mix of military, civilian and contractor personnel necessary to accomplish the mission of the Department of Defense. ARWG supports the implementation of a total force management plan that includes the important role of contractors. However, Section 931 (f)(2) specifically states:

> "Nothing in this title may be construed as authorizing….the use of contracts for functions that are inherently governmental or closely associated with inherently governmental even if there is a civilian personnel shortfall in the Department of Defense."

As currently written, the term "title" in Section 931 (f)(2) refers to all of title 10. Thus, Section 931 reinforces the misguided notion that work that is closely associated with inherently governmental functions is a separate category that should not be performed by the private sector. Currently, that is not the policy for DoD, nor does it conform with Office of Management and Budget policy guidance that clearly states that it is permissible to contract for closely associated with inherently governmental functions as long as agencies retain critical capabilities and management expertise.

RECOMMENDATION:
ARWG recommends that Section 931 be amended to state that nothing in title 10 should be construed as prohibiting the use of contracts for functions that are closely associated with inherently governmental functions provided that the department maintains sufficient organic expertise and technical capability. Section 931 should retain the language that restricts the use of contracts for inherently governmental functions.

HOUSE SECTION 939 (H.R. 1540) - CONVERSION OF CERTAIN FUNCTIONS FROM CONTRACTOR PERFORMANCE TO PERFORMANCE BY DOD CIVILIAN EMPLOYEES

DISCUSSION:
Current law requires DoD to develop guidelines and procedures to give special consideration to using DoD civilian employees to perform any function that is performed by a contractor and:

- Has been performed by DoD civilian employees at any time during the past 10 years;
- Is a function closely associated with the performance of an inherently governmental function;
- Has been performed pursuant to a contract awarded on a non-competitive basis; or
- Has been performed poorly, as determined by a contracting officer during the 5-year period preceding the date of such determination, because of excessive costs or inferior quality.

Section 939 would add "inherently governmental functions," "acquisition workforce functions," and "critical functions necessary to maintain sufficient organic expertise and technical capability" to the above list and does NOT remove or modify any of the existing items. ARWG does not object to adding "inherently governmental functions" or "critical functions…." to the list. However, ARWG believes that retaining the category "closely associated with inherently governmental functions" and adding "acquisition workforce functions" to the list is only appropriate if both are specifically tied to the agencies' need to maintain sufficient expertise and technical capabilities, i.e. the agency should only insource these functions to the extent necessary and should NOT embark on broad efforts to insource ALL closely associated with inherently governmental functions and ALL acquisition workforce functions. Many of these functions are commercial in nature and are perfectly suitable for private sector performance.

Furthermore, the current requirement that agencies seek to insource work simply because it was performed by a DoD civilian employee at any time during the past 10 years is a non-strategic approach to rebuilding the department's workforce and should also be removed from the list. In addition, work determined by a contracting officer to be poorly performed should only be considered for insourcing if it has also been determined that recompetition is not a more suitable alternative.

Section 939 also requires DoD to develop a public versus private sector cost comparison methodology based on DoD's Directive-Type Memorandum 09-007; ARWG and the May 2011 Center for Strategic International Studies (CSIS) report titled "DoD Workforce Cost Realism Assessment," have noted that the DTM fails to incorporate a number of important cost factors, such as the fully burdened government-wide costs of in-house performance and the full cost of DoD-owned capital.

Lastly, section 939 requires DoD to provide contractors affected by insourcing decisions "timely notification" about the department's decision to convert the work to in-house performance. While ARWG supports providing such notice, the provision fails to specify how much notice is required, nor does it require that contractors be provided with any

documentation, analysis, or cost comparison used by the department to justify its decision to insource.

RECOMMENDATION:
ARWG recommends that section 939 be modified to direct DoD to give special consideration to using DoD civilian employees for acquisition workforce functions and closely associated with inherently governmental functions only to the extent necessary to maintain sufficient in house organic expertise and technical capability. In addition, section 939 should be modified to eliminate the phrase "Has been performed by DoD civilian employees at any time during the past 10 years."

ARWG also recommends that the DTM be modified to address the shortcomings identified in the May 2011 CSIS report titled "DoD Workforce Cost Realism Assessment," and that documentation of the cost analysis used by DoD to determine its insourcing decisions be provided to the contractor that would be impacted by the decision to insource.

SENATE SECTION 821 (S. 1253) - INCLUSION OF DATA ON CONTRACTOR PERFORMANCE IN PAST PERFORMANCE DATABASES FOR SOURCE SELECTION DECISIONS

Section 821 would require the Department of Defense to change the process for evaluating the past performance of contractors, by making such evaluations available for use as information in a source selection as a discriminator between offerors, prior to providing contractors notice and an opportunity to be heard (and thereby denying contractor's administrative due process).

DISCUSSION:

FAR 42.15 requires the preparation and submission of past performance evaluations to the Past Performance Information Retrieval System (PPIRS). The FAR is currently being amended to consolidate the several databases that make up PPIRS and to harmonize the rating factors for all contracts[1].

FAR 42.1503(b) provides contractors with administrative due process by giving them a minimum of 30 days to respond to the past performance evaluations and requires that an individual one level above the rater consider the contractor's rebuttal, if any, before the past performance evaluation is finalized and entered into the system and thus available for consideration in subsequent source selections[2].

There is a fundamental problem with the proposed statutory language. The language would deny contractors administrative due process by denying the contractors notice and an opportunity to be heard before potentially adverse information is made available for use in subsequent source selections across the government. The current FAR process provides contractors due process and for this reason contractors cannot challenge the past performance information already in the Past Performance Information Retrieval System (PPIRS) when it is properly used in a subsequent source selection. If, however, a source selection official considers past performance information that the contractor believes is inaccurate and there has been no referral of the information to the contractor for comment before its use, the contractor will be able to challenge the use of the information during the source selection through the bid protest process. Protests filed over the use of this past performance information will not save the government time and money and will not improve the source selection process, quite the contrary, it will increase the cost and time to the government to acquire goods and services.

In the report, the committee noted that section 821 would impose the same approach to contractor comments to contractor past performance that Congress has taken with respect to the Federal Awardee Performance and Integrity Information System (FAPIIS). However, there is a fundamental difference in the use of information from the FAPIIS data base that justifies different treatment of due process for contractor past performance information in PPIRS. The information in FAPIIS is one element of past performance information and in contractor responsibility determinations and is based largely on publicly available, factual information. Past

[1] See FAR Case 2009-11, Documenting Contractor Performance, published 06-28-2011

[2] FAR 15.304(c)(3) requires that past performance be considered in all source selections of negotiated competitive contracts above the simplified acquisition threshold unless the contracting officer documents the reason past performance is not an appropriate evaluation factor for the acquisition.

performance information in PPIRS can be based on more subjective evaluation and yet be a specific factor in a source selection process.

Further, the Committee mischaracterizes the problem that the Office of Federal Procurement Policy has been trying to correct for a number of years. The problem is not that the due process afforded contractors by the current rule slows down the process so that there is inadequate past performance information in the system for use by contracting officers. The problem is, and has been, that contracting officers fail to complete the past performance evaluations in accordance FAR Subpart 42.15 at all. The Commission on Wartime Contracting found the same problem, that is, that contracting officers fail to complete the reports. There is no evidence in the Commission's February 24, 2011 report to the effect that providing contractors' their past performance evaluations for comment and waiting 30 days for their comments resulted in past performance evaluations not being filed in PPIRS and thus supports its conclusion that affording contractors administrative due process is slowing down the process.

RECOMMENDATION:

ARWG recommends that, rather than changing the current process which affords contractors due process with regard to their past performance evaluation determinations, section 821 be amended to require that timely completion and submission of past performance evaluations be included in the performance plans of contracting officers and their supervisors. Such a requirement will ensure that the population of PPIRS with past performance evaluations for subsequent use in source selections is timely while preserving appropriate safeguards for affected contractors. Further, ARWG suggest that the Committee consider an additional requirement to the effect that if the contractor fails to respond within 30 days after having received its past performance evaluation for comment that the contractor is deemed to have no objection to the past performance evaluation.

SENATE SECTION 823 (S. 1253) - TEMPORARY LIMITATION ON AGGREGATE ANNUAL AMOUNT AVAILABLE FOR CONTRACT SERVICES

DISCUSSION:
This section would implement a cap on DoD spending for contract services in fiscal years 2012 and 2013 at the level of the President's budget request for fiscal year 2010. This section requires the department to develop implementing guidance that specifically directs the military departments and defense agencies to establish a negotiation objective that labor rates and overhead rates in any contract or task order for contract services awarded in FY 2012 or 2013 shall not exceed labor rates and overhead rates paid to the contractor for contract services in FY 2010. This section also includes a 10 percent reduction in funding for staff augmentation contracts and contracts for functions closely associated with inherently governmental functions.

ARWG understands the importance of achieving efficiencies and budget savings within the department of defense and the Senate Armed Services Committee's desire to ensure that the department meets the savings goals outline by former Secretary of Defense Robert Gates in August, 2010. However, ARWG opposes the implementation of arbitrary, across-the-board cuts or freezes, whether they are to civilian personnel or to contractors. Such cuts may result in needed mission requirements going unfulfilled. Instead, the department should be required to assess its mission needs and make cuts where appropriate, regardless of whether those cuts, combined with other added mission requirements, result in actual cuts or increased need for in-house or contractor personnel.

Additionally, directing the department to adopt a negotiation objective of holding contractor labor and overhead rates to 2010 levels is misdirected. While overhead and labor rates typically increase, the increase in spending on services cannot, and should not, be attributed to rising labor and overhead costs. Such costs are driven by market factors and in many cases other government mandates that drive up such costs. For example, increased contractor reporting and oversight requirements mandated through legislation have played a pivotal role in driving up contractor overhead. In addition, in many cases, the Department of Labor dictates through the Service Contract Act the labor and health and welfare rates that contractors must pay their employees. In recent years, the labor rates and the health and welfare rates required by DoL have increased. Thus, requiring DoD to negotiate lower rates may create a discrepancy between DoD policy and DoL mandatory requirements.

RECOMMENDATION:
ARWG recommends that Section 823 be dropped from the final bill.

SENATE SECTION 841 (S. 1253) - TREATMENT FOR TECHNICAL DATA PURPOSES OF INDEPENDENT RESEARCH AND DEVELOPMENT AND BID AND PROPOSAL COSTS

Section 841 would amend 10 U.S.C. 2320 with respect to the treatment of independent research and development and bid and proposal (IR&D/B&P) funding for the allocation of rights in data in certain cases. The section would replace the changes to the statute enacted in section 824(b)(2) of the NDAA for FY 2011 that confers unlimited rights in data to the government in cases where the sole contractor investment in the development of an item or process is through investment in IR&D/B&P. Section 841, in contrast, would introduce the concept of "government purpose rights" (the right to use the data for government purposes, including future competitive procurements) into 10 U.S.C. 2320 and confer such rights in technical data pertaining to an item or process that is developed with IR&D/B&P in the case of: (1) an item or process for which the contractor contributed less than 10 percent of the total development costs with costs not actually allocated to Federal contracts (e.g., IR&D costs allocated across commercial contract bases or costs paid for with other contractor funds); or (2) an item or process that is integrated into a major system and either: (a) cannot be segregated from the system as a whole for purposes of competition, or (b) the contractor contributed less than 50% of the total development costs with costs not actually allocated to Federal contracts. In all other cases, contractor IR&D/B&P costs would continue to be treated as contractor private investment for the purposes of allocating rights in technical data. The changes in section 841 would apply to any contract entered into on or after January 7, 2011, the date of enactment of the NDAA for FY 2011.

DISCUSSION:
There is a need to balance the requirements for increased competition and the value of continued access to private sector innovation to support DoD missions. DoD continues to emphasize the importance of this balance. In the DoD efficiency initiatives, there are clear references to the importance of innovation, attracting non-traditional suppliers, increasing competition, and consideration of total life cycle costs, especially in early acquisition planning. ARWG commends the Senate Armed Services Committee for including language in section 841 to replace section 824(b)(2) of the NDAA for 2011 with statutory changes intended to balance the interests of the government and industry, and for including in revised 10 U.S.C. 2320(a)(4)(B)(ii)(II) a provision that, in instances where the Government is reprocuring a major system, allows contractors to retain control of their intellectual property rights in items or processes that can be segregated from that major system. ARWG believes, however, that the Section 841 approach has fundamental flaws that require consideration of an alternative that would enable DoD to competitively reprocure major systems with embedded proprietary items or processes and at the same time avoid the negative consequences associated with changing the cost classifications of IR&D/B&P.

ARWG proposes an alternative approach that would (1) amend 10 U.S.C. 2320 to clarify the authority of DoD to use the rights in data for an item or process that is developed with mixed funding for the competitive reprocurement of a major defense acquisition system under a major program or subprogram; and (2) restore IR&D/B&P to private expense cost classifications.

I. The New Allocability Test Could Not Be Implemented Concurrently with Technology Development

Under existing law, data rights determinations are primarily based on the source of funding used to "develop" an item or process to which technical data pertain. This enables contractors to make data rights determinations concurrently with technology development, including those occurring under IR&D and B&P projects. In contrast to existing law, Section 841 sets forth a new "allocability test" in 10 U.S.C. 2320(a)(4) that would make it difficult or impossible for a contractor to make data rights determinations concurrently with technology development. The allocability test in section 841 would focus on whether a threshold percentage (either 10% or 50%) of the total development costs for items or processes are: (1) "allocable" to contracts other than Federal contracts, or (2) paid for with company funds (out of profit). In order to apply this allocability test, a contractor would have to determine the percentage of IR&D and B&P costs which have actually been allocated to Federal contracts and to commercial business over a specific period of time. Contractors would only be able to make this factual determination on an annual basis after "final indirect cost rates" are known – generally within the 6-month period following the end of each contractor's fiscal year (see FAR 52.216-7(d)). Until such time as final indirect cost allocations are known on an annual basis, contractors would only be able to estimate or predict IR&D and B&P allocations based on interim "billing rates" such as forward pricing rates (see FAR Subpart 42.7). This raises the following questions:

- Does Congress expect that contractors will use estimated and interim billing rates to predict actual IR&D and B&P allocations in order to make data rights determinations for proposals submitted to DoD when final indirect cost allocations for such IR&D and B&P projects are not yet known even to the contractor?
- There are almost always variances between interim billing rates and final indirect cost allocations. Would contractors have to go back and reconcile assertions made in accordance with interim billing rates once final indirect cost allocations are known? Further complicating matters is the fact that billing rates and final indirect cost allocations may not separately identify the percentage of IR&D and B&P costs allocated on an IR&D/B&P project-by-project basis.

II. The New Allocability Test Would Be Costly, Complicated and Ambiguous

In order to protect their rights in technical data under the new allocability test, contractors would have to develop and implement new accounting systems, or modify existing accounting systems, to track the allocation of development costs over time. The costs associated with developing and implementing such new or revised accounting systems would increase overhead costs and drive increases in rates. The risk of inadequate tracking systems would especially undermine small businesses' commitment to make investments in innovation for government customers.

IR&D and B&P would also become chameleon-like "colors of money" that could change color from "Federal funds" to contractor "private expenses" depending on how costs are ultimately allocated. This complicated approach would be confusing and difficult for both the contractor to implement and the government to monitor. Further complicating matters would be the possibility for specific IR&D funds to simultaneously be considered both Federal funds and private expenses. For example, a contractor could (as contractors often do) "develop" a software

module under an IR&D project and integrate the module into two separate software programs currently under development (Software Programs A and B). If Software Program A is "developed" with at least 50% of costs not actually allocated across Federal contract bases over a specific period of time, while Software Program B is "developed" with less than 50% of costs not actually allocated across Federal contract bases over a specific period of time, then, for the purposes of Software Program A, such IR&D funding would be a "private expense" while the same IR&D funding would be "Federal funds" for the purposes of Software Program B. Congress should consider the alternate approach proposed herein that would not impact the longstanding cost classifications for IR&D and B&P.

The allocability test would also create uncertainty in data rights determinations and may lead to an increase in disputes between DoD and industry. On one hand, the allocability sets forth two very specific thresholds (10% or 50% of the "total amount" of development costs) for determining whether IR&D and B&P are Federal funds or private expenses. This would require contractors to track every single dollar of development costs over a specific period of time. However, the revised statutory language does not define "developed" or specify over which period of time measurements for the "total amount" of development costs would be calculated. A precise, objective definition of "developed" would be necessary in order to track total development costs on a dollar-by-dollar basis and calculate the necessary percentages to comply with such a specific test. Further, many IR&D projects span multiple fiscal years. During the development cycle, the percentage of development costs not actually allocated across Federal contracts bases could bounce above and below the 10% or 50% thresholds on an annual basis.

Finally, individual contractors may not have access to data necessary to determine the total amount of development costs. In the case of an item or process that has been developed in part by a contractor and in part by another party or other parties – such as subcontractors, partners, universities, government-funded laboratories, consortia, commercial vendors or Government entities – the contractor offering the item or process for sale to the Government would need to determine: (1) the amount of development costs each party expended in developing its portion of the item or process, and (2) how such development costs were actually allocated over time. In most cases, contractors would not know the other parties' development costs and allocations and would have no means for obtaining such information. For example, DoD commonly issues solicitations that set forth software reuse strategies and open systems architecture approaches. DoD commonly furnishes legacy software developed by other contractors, universities or Government entities to the successful offeror as Government Furnished Information or Software (GFI/S). Suppose the successful offeror integrates portions of such GFI/S with a software program which had been developed substantially with costs not allocated across Federal contract bases. The contractor would have no means of calculating the total amount of development costs expended by the developers of the portions of such GFI/S in order to determine the specific percentages of total development costs for the whole.

III. The Minimum 50% Private Sector Investment Threshold For Major Systems Discourages Private Sector Technology Investment and Innovation

Section 841 would modify 10 U.S.C. 2320 such that – in the case of an item or process to be integrated into a major system – IR&D/B&P costs would only be considered "private expenses"

if: (i) at least 50% of the total development costs are not actually allocated to Federal contracts (either directly or indirectly), and (ii) the item or process is segregable from other elements of the major system.

The 50% threshold marks a significant departure from longstanding DoD policy and could have a chilling effect on the willingness of companies to make IR&D/B&P investments. As noted above, indirect costs such as IR&D and B&P have been considered independent private expenses – and not Federal funds – for the purposes of determining the Government's rights in contractors' technical data. This was a central element in DoD's longstanding policy of encouraging companies to invest in dual use technologies, encouraging private sector innovation, and attracting cutting edge commercial technology developers to supply DoD. Over time, the DoD's policy has led to more competition and lower costs, and enabled the DoD to leverage commercial technologies and innovation without undermining a contractor's ability to retain the competitive advantage associated with such technological breakthroughs.

If the changes in section 841 are enacted, DoD contractors which have little non–Federal government contract business on which to allocate IR&D/B&P, or who are unable to invest company profits in amounts necessary to meet or exceed the 50% threshold for technology development, would have little or no incentive to develop or mature technologies under IR&D projects as their rights in technical data (and software) would be put at risk.

RECOMMENDATION:

ARWG supports section 841 as a general improvement over section 821(b)(2) of the FY11 NDAA. However, the allocability test set forth in section 841 is too complicated and would be impossible to implement given the very dynamic manner in which items and process are developed and the funding accounted for over time. Establishing such new requirements in law would create significant uncertainty associated with data rights determinations, serve to discourage private sector technology investment and impair continued Government access to breakthrough technologies developed in the private sector. Such private sector investment and innovation is critical to ensuring that taxpayers truly benefit from competition. The negative consequences of the proposed changes could not be reasonably mitigated and would outweigh any measurable benefit to the Government. Accordingly, ARWG recommends striking the proposed 10 U.S.C. 2320(a)(4) (as modified by section 841) and consider the attached alternate approach that would provide for competition of major systems without impacting the longstanding cost classifications for IR&D and B&P. The implementation of such an alternate approach should focus on the circumstances under which DoD would receive a license solely for the Government purposes of reprocuring a major defense acquisition system.

Proposed changes to relevant sections of 10 U.S.C. 2320 in lieu of section 841:

(Bold font and strikethroughs indicate section 841 changes to 10 U.S.C. 2320(a). Industry-suggested changes are shown in bold/italicized font (suggested new language) and highlighted strikethroughs (suggested deletions of section 841 changes to 10 U.S.C. 2320(a)).

10 U.S. C. 2320(a) is amended:

In paragraph (2), by redesignating subparagraphs (E), (F) and (G) as subparagraphs (F), (G) and (H) respectively, and by inserting the following new subparagraph (E):

(E) Notwithstanding subparagraph (B), except for and excluding all commercial items and processes, the United States may acquire and use technical data and rights therein pertaining to an item or process, or release or disclose such technical data to persons outside the Government and permit the use of such technical data by such persons, pursuant to a license obtained by the United States in accordance with this subparagraph. Such license may be obtained only if and to the extent the Secretary of Defense determines, after consideration of alternatives, that such use, release, or disclosure is necessary to allow a competitive reprocurement of a major system previously delivered under a full production contract under a major defense acquisition program, or a designated major subprogram (as determined by the Secretary under section 2433(d) of this title) thereunder, and the item or process is integrated into such major system.

(i) In such case, the Secretary of Defense may—

(I) Enter into a contract with the contractor or subcontractor that owns such technical data to acquire a license to use, release and disclose such technical data as described in this subparagraph in order to permit, and for the sole and limited purpose of enabling, the United States to competitively reprocure such major system; or

(II) Permit such contractor or subcontractor to license such technical data directly to a third party for such limited purpose.

(ii) Upon the receipt of written notification from the Government that the Secretary of Defense has determined that such license is necessary to allow a competitive reprocurement of such major system, the contractor or subcontractor shall promptly enter into negotiations with the Government, or such third party identified by the Government, to grant such license for the sole and limited purpose of enabling the United States to competitively reprocure such major system.

(iii) The contracting parties shall negotiate a fair and reasonable price for both the license rights in such technical data pertaining to such item or process and the effort required to convert such technical data into the prescribed form and reproduce and deliver such technical data.

By amending subparagraph (F) as redesignated to read as follows:

(F) In the case of an item or process developed in part with Federal funds and in part at private expense, ~~**the respective rights**~~ **the Government may,** ***unless otherwise negotiated with the contractor,*** **use, modify, release, reproduce, perform, display, or disclose** ***technical*** ~~**the**~~ **data pertaining to such item or process within the Government without restriction** ***and*** ~~**but**~~ **may**

release or disclose *such* ~~the~~ data outside the Government only for Government purposes. The respective rights of the United States and of the contractor or subcontractor in technical data pertaining to such item or process, shall be established as early in the acquisition process as practicable (preferably during contract negotiations) and shall be based upon negotiations between the United States and the contractor, except in any case in which the Secretary of Defense determines, on the basis of criteria established in the regulations, that negotiations would not be practicable. The establishment of such rights shall be based upon consideration of all of the following factors:

(i) The statement of congressional policy and objectives in section 200 of title 35, the statement of purposes in section 2(b) of the Small Business Innovation Development Act of 1982(15 U.S.C. 638 note), and the declaration of policy in section 2 of the Small Business Act (15 U.S.C. 631).

(ii) The interest of the United States in increasing competition and lowering costs by developing and locating alternative sources of supply and manufacture.

(iii)The interest of the United States in encouraging contractors to develop at private expense items for use by the Government.

(iv) Such other factors as the Secretary of Defense may prescribe.

By amending paragraph (3) to read as follows:

(3) The Secretary of Defense shall define the terms "developed", "exclusively with Federal funds", and "exclusively at private expense" in regulations prescribed under paragraph (1). In defining such terms, the Secretary shall specify the manner in which indirect costs shall be treated ***and shall specify that amounts spent for independent research and development and bid and proposal costs shall not be considered to be Federal funds.*** ~~for the purposes of paragraph (2)(B), but shall be considered to be Federal funds for the purposes of paragraph (2)(A)~~.

ARWG supports Section 841(b) on the effective date: **"The amendments made by subsection (a) shall take effect on January 7, 2011, immediately after the enactment of section 824(b)(2) of the Ike Skelton National Defense Authorization Act for Fiscal Year 2011 (Public Law 111-383; 124 Stat. 4269), to which such amendments relate."**

SENATE SECTION 842 (S. 1253) - EXTENSION TO ALL MANAGEMENT EMPLOYEES OF APPLICABLITY OF THE SENIOR EXECUTIVE BENCHMARK COMPENSATION AMOUNT FOR PURPOSES OF ALLOWABLE COST LIMITATION UNDER GOVERNMENT CONTRACTS

SEE HOUSE SECTION 803

SENATE SECTION 843 (S.1253) - COVERED CONTRACTS FOR PURPOSES OF REQUIREMENTS ON CONTRACTOR BUSINESS SYSTEMS

DISCUSSION:
This section would broaden the definition of a "covered contract" under what is known as the "Business Systems Rule" by redefining the term to mean "a contract that is subject to the cost accounting standards promulgated pursuant to section 1502 of title 41, United States Code that could be affected if the data produced by a contractor business system has a significant deficiency." This has the effect of adding fixed price contracts to the list of contracts from which DoD can withhold funds if there is a significant deficiency in a business system.

Last year, in the Ike Skelton National Defense Authorization Act for Fiscal Year 2011, section 893(f)(3), Congress defined a "covered contract" to be a "cost-reimbursement contract, incentive-type contract, time-and-materials contract, or labor-hour contract that could be affected if the data produced by a contractor business system has a significant deficiency." On May 18, 2011, DoD released an interim Business Systems rule with request for comments (76 Fed. Reg. 28856). The interim rule did not follow the requirements in the FY11 National Defense Authorization Act, because it unnecessarily expanded the definition of "covered contract" to include all contracts subject to Cost Accounting Standards, including fixed price contracts.

RECOMMENDATION:
ARWG opposes Section 843 and recommends that it be removed from the final version of the bill. Negotiated Firm Fixed Price contracts should be exempt from the "Business Systems Rule". System deficiencies in business systems covered by this provision and the interim rule would not result in actual or potential harm to the government under this contract type because the total government liability is fixed. Expanding the term "covered contracts" to all CAS contracts needlessly adds another level of bureaucracy and limits cash flow to defense contractors in a climate where defense funds are and will continue to be limited. DoD and Congress are demanding affordability in every step of the acquisition process. The proposal would not limit any harm to the government and would not improve the capability of the delivered product or service but would damage contractors that are seeking to reduce costs.

SENATE SECTION 845 (S.1253) - PROHIBITION ON COLLECTING POLITICAL INFORMATION

SEE HOUSE SECTION 847

SENATE SECTION 847 (S. 1253) - COMPTROLLER GENERAL OF THE UNITED STATES REPORTS ON NONCOMPETITIVE AND ONE-OFFER CONTRACTS AWARDED BY THE DEPARTMENT OF DEFENSE

Section 847 requires the Comptroller General to conduct a review of non-competitive contracts and contracts where DoD received only one offer and provide a report to the Congress for FYs 2012, 2013 and 2014.

DISCUSSION:

The requirement for these reports does not distinguish between contracts where one-offer was received and those contracts where "logical follow-on" was used as a basis for obtaining only one offer. Logical follow-on is recognized as an exception to both the Competition in Contracting Act and Fair Opportunity in the Federal Acquisition Streamlining Act.

In order for the report to be useful in improving competition and compliance with Fair Opportunity, it should distinguish between those instances where logical follow-on was the basis of award and determine whether the use of logical follow-on was properly used in those circumstances.

RECOMMENDATION:

ARWG recommends that the section be amended to require that the Comptroller General break out in its reports those instances in which logical follow-on was used as a basis of award and an analysis of whether the use of logical follow-on was consistent with applicable statutory and regulatory guidance.

SENATE SECTION 861 (S.1253) - PROHIBITIONS ON CONTRACTING WITH THE ENEMY IN THE UNITED STATES CENTRAL COMMAND THEATER OF OPERATIONS

DISCUSSION:
This section would authorize the head of a contracting activity to void a contract or restrict the award of future contracts to a contractor who has been determined by the Commander of United States Central Command to be actively opposing U.S. forces in Afghanistan. The provision also permits DoD to terminate for default contracts in which the department determines the contractor has not exercised due diligence to ensure that funds associated with the contract are not flowing to adverse entities.

Although ARWG supports the intent of this provision, we have a number of concerns with how it is structured. For example, the provision fails to provide guidance about what constitutes "due diligence" on the part of contractors for ensuring that contract funds are not flowing to adverse entities. Furthermore, the language inappropriately allows for the government to terminate for default contracts in which the contractor has not exercised due diligence, even if there is no finding or evidence that funds related to the contract have been flowing to adverse entities. Additionally, the timelines set forth within the bill do not provide adequate time for contractors to implement requirements prior to full enforcement of the provision. Specifically, the bill language requires the Defense Supplement to the Federal Acquisition Regulation (DFARS) to be amended to grant authority to the department to void or terminate contracts or restrict competition, and to insert a clause in contracts requiring the contractor to exercise due diligence within 30 days of enactment of the act. Hence, the department will have the authority to terminate for default contracts in which the contractor has not exercised due diligence even though the contractor has not been afforded any opportunity to implement due diligence procedures that may, or may not, be provided in the implementing guidance. The broader authority to terminate for default even if there is not actual finding or evidence that funds are flowing to adverse entities further complicates this provision.

The provision also fails to appropriately place responsibility on the government to share with prime contractors information about who they may, or may not, subcontract with. Although the legislation grants limited authority for the government to share information with contractors, ARWG believes that the government should bear greater responsibility to share information so that contractors can avoid inappropriately subcontracting with adverse entities or can eliminate existing subcontracts with adverse entities before their contracts are voided or terminated for default. In many cases, contractors may be unable to assess whether funds to subcontractors are flowing to adverse entities even when due diligence is exercised. In such instances, it would be unfair to penalize prime contractors, especially when the government could have shared intelligence with the company to avoid the partnership. DoD and USAID have undertaken initiatives to vet non-U.S. vendors in Afghanistan prior to and after contract award to ensure that contract funds are not being used to fund adverse activities. Such efforts to protect against misuse of U.S. funds should be supported and to the maximum extent practicable, these efforts should focus on pre-award efforts to vet contractors. A GAO report issued on June 8, 2011 expressed concern that vetting efforts might be under-resourced and that USAID and DoD formalize procedures to increase collaboration for contractor vetting.

Lastly, this section is also unclear about how prime contractors would be reimbursed for expended funds to subcontractors that are supporting adverse entities. For example, in many instances, prime contractors expend funds on subcontractors with the understanding that they will later be reimbursed by the government for incurred costs. If, in the meantime, the subcontractor is discovered to be supporting adverse entities and the prime contractor is directed to void the contract with the subcontractor, it is likely that the prime contractor would NOT be reimbursed for any funds that were incurred or paid in good faith to the subcontractor. To avoid unfairly penalizing prime contractors or higher tier subcontractors that have no way knowing that one of their subcontractors was funneling support to adverse entities, the language should clarify that prime contractors or higher tier subcontractors will be reimbursed for expended funds in instances where they have already paid the subcontractor and had no knowledge that the subcontractor was funneling funds to adverse entities.

Section 861 fails to recognize a number of other actions that the Secretary of Defense may take in instances where companies have been found to have violated this section. For example, in lieu of voiding contracts and subcontracts, the Secretary should be given the flexibility to enter into other administrative agreements that more appropriately address the severity and specific details of the violations.

RECOMMENDATION:
ARWG recommends the Section 861 be amended to explicitly require the department to work with industry to identify due diligence procedures and best practices. In addition, the timelines in the legislation should be modified to appropriately allow contractors to implement due diligence guidance prior to granting the department the authority to terminate for default contracts in which the contractor has not exercised due diligence.

Lastly, ARWG encourages Congress to ensure that federal agencies are appropriately resourced and are working collaboratively on non-U.S. vendor vetting efforts. Furthermore, in instances where the U.S. government has undertaken vetting initiatives, the results should be made available to contractors so that they can rely on the information to help them make informed decisions about who the may or may not contract with. When contractors rely on the vetting information provided by the U.S. government, they should be afforded a safe harbor from penalties unless they knowingly contract with adverse entities.

SECTIONS ARWG SUPPORTS

- Senate Section 801
- Senate Section 802
- Senate Section 824
- Senate Section 845
- Senate Section 864
- Senate Section 881
- Senate Section 885
- Senate Section 886
- Senate Section 887
- House Section 847
- House Section 849
- House Section 965
- House Section 1116

About the Acquisition Reform Working Group

The Acquisition Reform Working Group (ARWG) is comprised of the Aerospace Industries Association, American Council of Engineering Companies, American Council of Independent Laboratories, National Defense Industrial Association, Professional Services Council, TechAmerica, The Associated General Contractors of America, The Coalition for Government Procurement and the U.S. Chamber of Commerce. We represent thousands of small, mid-sized and large companies and hundreds of thousands of employees that provide goods, services and personnel to the government.

Should you have questions about these comments, perspectives and recommendations, please contact Roger Jordan of the Professional Services Council at jordan@pscouncil.org or 703-875-8059.