



# **Acquisition Reform Working Group\***

## **2011 Legislative Recommendations**

**March 11, 2011**

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\* ARWG consists of the Aerospace Industries Association, American Council of Engineering Companies, The Associated General Contractors of America, The Coalition for Government Procurement, National Defense Industrial Association, Professional Services Council, TechAmerica, and the U. S. Chamber of Commerce

## **ISSUE: MAXIMIZING A BLENDED WORKFORCE**

The need for a well trained workforce to meet the federal government's missions remains critically important. A Congressional focus on reducing department budgets, in part through hiring and pay freezes for federal employees while also reducing the use of contractor support, are factors that will impact how departments and agencies meet current and growing demands without an increase in resources. Given these constraints, the federal government clearly needs to focus on managing the entirety of its workforce in an effective and efficient matter. This means agencies must adopt strategies that incorporate and rely on a blended workforce—one comprised of federal employees and contractor support. Such strategies should avoid a push toward arbitrary insourcing or contracting for work without proper analysis and should encompass specific support for on-going efforts to rebuild the government's acquisition workforce.

### **DISCUSSION:**

#### *Rebuilding the Acquisition Workforce*

Many of the problems with defense and other agency acquisitions today are the result of severe strains being placed on the federal government's acquisition workforce rather than a lack of appropriate rules and regulations. That strain has been caused by a confluence of events: reductions in the DoD workforce mandated by Congress in the 1990s as the defense budget declined; continued efforts in successive Administrations to reduce the size of the military and of government overall; a moratorium on hiring new personnel for a significant period of time; an increase in federal contract spending; and the challenge of contingency operations in Afghanistan and Iraq. In addition, new acquisition process requirements and stringent new interpretations of existing requirements have significantly increased the workload of acquisition workforce.

Workforce issues are especially important to DoD, which has the largest acquisition workforce in the federal government. Demographic challenges caused in part by the anticipated retirement of baby boom generation acquisition workers argues strongly in favor of providing DoD as much latitude as possible in addressing workforce shortages in certain key acquisition categories. Yet even with current recruitment increases now being undertaken by DOD, there will remain a gap in the knowledge and experience level of the workforce as more experienced personnel retire. The HASC Panel of Defense Acquisition Reform acknowledged in its 2010 report on the DoD acquisition workforce that the quality of that workforce is at least as important as if not more important than the quantity of the acquisition workforce. Secretary of Defense Gates has also recognized this and continues to direct the department to focus its insourcing efforts on rebuilding the acquisition workforce, though evidence suggests that those are not the skills set actually being insourced in the field. Furthermore, Secretary Gates has properly exempted acquisition workforce functions from his freeze on DoD personnel levels.

#### *Avoid Non-Strategic Insourcing*

Achieving the appropriate balance between federal employees and private sector support is important for managing the blended workforce; while many initiatives have been set in motion, little has been finalized. First, on July 29, 2009 the Office of Management and Budget (OMB) published guidance for the federal agencies titled "Managing the Multi-Sector Workforce". This guidance laid out the considerations for agencies when making their sourcing decisions, though we remain concerned that those with decision-making authority could decide to convert work from private sector to public sector performance with little analysis or justification. Second, the guidance was intended to coincide with guidance from OMB providing clarification of the definition of functions that are; 1) inherently governmental and must be performed by federal employees; 2) closely associated with inherently

governmental functions; and 3) critical to agency missions. Though a draft policy memo titled “Work Reserved for Performance by Federal Government Employees” was published by OMB on March 31, 2010, and commented on extensively by industry and others, as of March 10, 2011, the final guidance has not been published.

Legislative proposals have also offered proposals that encourage greater insourcing without requiring an assessment of the costs of doing so or providing adequate transparency into the decision-making process. One such example is language that was included in Section 850 of the House-passed version of the National Defense Authorization Act of 2011. The language would have directly contradicted the OMB balanced workforce guidance by requiring civilian agencies to insource functions closely associated with inherently governmental functions to the maximum extent practicable. Although such a standard currently exist for the Department of Defense, civilian agencies are currently required to ensure that sufficient management attention and oversight is being given to contracts that include closely associated with inherently governmental functions.

### **RECOMMENDATIONS:**

To appropriately balance the multi-sector workforce and increase the capacity of the federal acquisition workforce, ARWG recommends:

#### *Workforce*

- Congress should exempt acquisition workforce functions, inherently governmental functions, and functions critical to national security from any pay or hiring freezes.
- Congress should enact the “Acquisition Workforce Improvement Act of 2009,” (S. 2901, 111<sup>th</sup> Congress) that would establish an acquisition management fellows program, and the “Federal Acquisition Improvement Act of 2010” (S. 2902, 111<sup>th</sup> Congress) which passed the Senate on December 13, 2010, and that would update government-wide training and certification requirements for the federal acquisition workforce.

#### *Insourcing*

- Congress must exercise adequate oversight of how federal agencies are implementing the OMB July 2009 “Managing the Multi-sector Workforce” guidance and must respond to the pending final “Work Reserved for Performance by Federal Government Employees” guidance to ensure that agencies are not making arbitrary decisions to insource functions. Such guidance should NOT encourage the insourcing of broad categories of functions, but should instead encourage departments to strategically identify positions in which the department needs to retain its core capabilities
- Adopt a government-wide standard for how agencies are to manage “closely associated with inherently governmental functions.” The standard should be based on the current civilian agency and OMB standards requiring that proper management and oversight attention be given to such functions, and not the current DoD standard included in 10 U.S.C. 2330a (e) (2) (C) requiring such functions to be insourced to the maximum extent practicable.
- Require agencies to justify their insourcing decisions and ensure that agencies conduct strategic analyses prior to insourcing functions that are not inherently governmental or positions critical to national security. The analyses must including an “apples-to-apples” life-cycle cost comparison between the public and private sectors, with consideration of functions and work that involves discrete efforts of limited duration for unique efforts requiring specialized skills and qualifications. The latter favors private sector use, with the ability to select and use such skills as needed.

- Assess the processes agencies use to make insourcing decisions, such as DoD's Directive Type Memorandum 09-007, to ensure they properly include all cost factors.
- Require a small business impact assessment as part of an agency's insourcing analysis.
- Establish an administrative review for companies potentially impacted to ensure that all businesses will, at minimum, be afforded some insight into the decision-making process and due process.
- Consider the impact on maintaining the industrial base in all sourcing decisions.

## **ISSUE: PRESERVING THE DEFENSE INDUSTRIAL BASE TO MEET THE NATION'S NATIONAL SECURITY NEEDS**

In America's earliest days our government relied on a combination of both public arsenals and private industry in the defense industrial base. The Department of Defense is now the world's premier consumer of modern military equipment, virtually all of which is manufactured by private industry. The knowledge 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. That specialized knowledge, resident in the aerospace and defense industry's workforce and manufacturing processes, is applied via unique systems engineering and integration capabilities to convert technologies first into systems and then into systems-of-systems. The ability to pass on knowledge of how to integrate or apply technological capabilities to highly specialized military applications distinguishes the aerospace and defense market from the commercial market. The bottom line is that the private sector defense industrial base exists to support the needs of our government customers.

The private component of the defense industrial base produces the world's highest technology military weapons systems. However, in recent years Pentagon acquisition and budget policies have had the effect of reducing the number of new defense systems sought. This has meant fewer new programs spaced further and further apart, resulting in a relatively small number of large-scale opportunities for the defense industrial base to continue to hone its technological edge.

This contraction and the accompanying shrinking set of opportunities 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 such outlays. 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. The loss of a single competition could mean that a corporation is driven out of a line of business, or elects to exit the business altogether. 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.

### **KEY CHALLENGES:**

The Budget and Lack of New Programs: Our industry knows our nation faces unprecedented fiscal constraints. With our primary customer, the U.S. Department of Defense, constituting 48% of federal discretionary spending, it is an obvious target for budget cuts aimed at reining in the deficit. The most significant threats to the defense industrial base are wholesale cuts in the defense budget without adequate analysis of potential threats and of impacts on the supplier base and future capability.

**Industrial Base Workforce:** It is important to remember that industrial base and workforce issues are interlinked and essential to continued prosperity. If the defense industry is seen as a declining or stagnant industry, it will be even harder to replace and attract the best talent. There is a limited supply of engineering talent in the U.S. who can receive the requisite clearances for sensitive work and a limited supply of skilled manufacturing talent. With limited demand in the defense arena, labor markets will adjust and skilled workers will follow the challenge and money, making it harder for the defense industry to compete.

**Financial:** Most defense companies are publicly traded companies, thus serving two masters: a monopsony controlled by its DoD customer and the company's shareholders. Company boards' responsibility to their shareholders requires that they deploy capital investment to those areas where returns will be highest. As returns decline, investment in new plant and equipment will decline. Furthermore, if shrinking budgets are combined with declining profit margins, there is a real danger that the investment community will downgrade the defense industry, leading to restructuring and a loss of capability. While the Department's policy makers' efficiency efforts are not focused on reducing margins, industry is already seeing operational personnel focusing on exactly this because, among other reasons, doing so is easier than reducing requirements that increase costs. If the practical effect of the efficiency initiative is reduced defense industry margins, private investment will shift away from the industry and pressure to consolidate will increase.

**Civil-Military Integration:** The trends of the past several years have made it harder to integrate the civil and military industrial sectors to solve DoD's problems. Issues ranging from export controls and threats to intellectual property to government-unique requirements and conflict of interest issues make those companies that do little business with DoD, but provide high value-added goods and services, think twice about entering or staying in the defense market.

**Supply Chain Capacity:** As evidenced by China's control of much of the rare earth supplies, the Department of Defense must gain greater visibility into the workings of the defense supply-chain's lower tiers in order to identify any supply-chain capacity vulnerabilities long before they pose a risk. Years of budget reductions, program and requirements instability have had a real and negative impact on the viability of smaller defense component manufacturers, which leaves us with an aerospace and defense supply chain that has neither the breadth nor the depth that we once had.

## **IMPORTANT DEVELOPMENTS:**

The Fiscal Year 2011 National Defense Authorization Act 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 establishment of a Deputy Assistant Secretary of Defense for Manufacturing and Industrial Base Policy.

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 a vital defense industry for decades to come:

1. **Communicate.** Congress and DoD need to communicate about priorities and resource constraints realistically with a good understanding of industry capabilities, which impact cost and timeliness, and consider impacts on industry that can affect its long-term abilities. As a result, industry can shape itself to meet the department's long-term needs at the most efficient level for the taxpayer

2. **Avoid wholesale 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. **Keep Procurement and RDT&E consistent at 35% 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. **Propose additional multi-year procurements** in order to provide industry with the ability to make long-term industrial base decisions.
5. **Increase the use of long-term performance and outcome-based contracts.**
6. Congress should **encourage 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 of the country and ensures appropriate risk assessments are conducted related to potential supply-chain capacity vulnerabilities.

We must continue to meet our national security needs despite shrinking budgets. That responsibility falls solidly on both government and industry. The relationship between the defense industrial base and its government customer has always been and must remain a partnership, one based on a mutual understanding of the unique challenges each must meet.

## **ISSUE: REVISING GOVERNMENT INTELLECTUAL PROPERTY POLICIES WHICH DISCOURAGE TECHNOLOGY INVESTMENT & INNOVATION**

### **DISCUSSION:**

ARWG urges Congress to repeal Section 824(b) of the 2011 National Defense Authorization Act (P.L. 111-383), and either repeal Section 824(c) or clarify that the Secretary's authorities 10 U.S.C. §2321(d)(2)(C), as modified, are non-delegable. Section 824(b) fundamentally changes U.S. Government policy regarding the acquisition of data rights, will be costly and difficult to implement, is ambiguously drafted and subject to multiple interpretations and unintended consequences, and does not sufficiently balance the interests of the Government and Industry. Section 824(c) imposes an unreasonable and costly administrative burden unless the Secretary of Defense exercises his rights thereunder only in limited and exceptional circumstances, and the exercise of such rights is non-delegable.

#### **I. Section 824(b) Fundamentally Changes U.S. Government Policy Regarding the Acquisition of Data Rights.**

Before the enactment of Section 824, indirect costs such as Independent Research and Development (IR&D) and Bid and Proposal (B&P) costs were *not* considered "Federal funds" for purposes of determining whether an item was developed exclusively with Federal funds under 10 U.S.C. §2320(a)(2)(A). Instead, under the prior law, all indirect costs were considered private expenses for purposes of establishing the Government's rights in technical data, even though such costs were allocable across government contracts via indirect cost pools, and contractors recouped a portion of their research and development ("R&D") expenditures in the price of products and services sold to the Government. Indirect costs, by definition, do not directly benefit specific contracts. For example, IR&D projects begin and end at different times and change direction in response to breakthroughs in technology, further underscoring the independent nature of such investments.

The DoD's prior decision to treat indirect costs as independent private expenses – and not Federal funds – was central to the 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 the DoD industrial base. Importantly, the DoD's longstanding policy was arrived at after many years of study and public debate. Over time, the DoD's policy 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 breakthroughs.

Although the newly enacted statutory language is ambiguously drafted, it apparently intends, in effect, that indirect costs such as IR&D and B&P be considered "Federal funds" – and *not* private expenses – for purposes of determining the Government's license rights to a contractor's technical data. As modified, 10 U.S.C. § 2320(a)(2)(A) enables the Government to obtain "unlimited rights" in technical data pertaining to items or processes developed with IR&D and B&P costs. In the past, such technical data would have been provided with "government purpose rights."

Contractors that attempt to recover the costs of their R&D investments by allocating IR&D and B&P to various products and services sold to the Government must now grant the Government "unlimited rights" in technical data pertaining to that technology and lose any competitive advantage over their competitors for government work who have not made the same investment. This is an apparently retroactive change in the longstanding framework for determining the Government's license rights in a contractor's technical data. It is also analogous to an unfair confiscation or improper "taking" of a company's intellectual property, because "unlimited rights" essentially provides the Government with rights that are coextensive with those of the intellectual property owner.

It remains to be seen how this change will affect companies' determination to invest in R&D since doing so may give the company no material advantage over those that do no investment, particularly in government markets.

As modified, 10 U.S.C. § 2320(a)(3) is a sea change in law and policy hidden in a provision addressing definitions. Moreover, this fundamental shift in law and policy was enacted without any public hearings or discussions of comparable provisions in either the HASC or SASC versions of the bill, and without conducting a study to assess the likely chilling effect on innovation and contractor IR&D investments.

## II. Section 824(b) will be Costly and Difficult to Implement.

Given the independent nature of IR&D, its ever-changing developments, and the historical practice of allocating IR&D costs to Government contracts via indirect cost pools, it will be virtually impossible, and a costly administrative burden, to demonstrate that such indirect costs were not allocated to any Government contract. Although the effective date of the statutory change is unclear, any effective date presents implementation challenges and the practical implication is that the change will be retroactive in application. The historical practice of allocating indirect costs to Government contracts via indirect cost pools will present significant challenges to funding determinations for all technologies which have been developed or partially developed prior to the statutory changes. One possible outcome is that the Government will receive, under future Government contracts, unlimited rights in all technical data pertaining to pre-existing items or processes which have been developed or partially developed with IR&D prior to the statutory change. This is an alarming outcome that does not sufficiently consider or balance the interests of contractors in protecting the intellectual property resulting from previous private expense investments.

## III. Section 824(b) is Ambiguously Drafted and Subject to Multiple Interpretations and Unintended Consequences.

As modified, the statutory language is internally inconsistent. As drafted, it results in a conundrum where, on the one hand, contractors may consider IR&D and B&P costs as a private expense when considering whether an item was developed at private expense under 2320(a)(2)(B), while at the same time, contractors must treat these funds as Federal funding under 2320(a)(2)(A). How can the DoD draft regulations that require a contractor to simultaneously consider these expenses to be both Federal and private funding? This language only begs the question as to what rights the Government is entitled. Finally, because of Cost Accounting Standards allocability requirements and appropriate bases for allocation, and the nature of development and evolving applications both for defense and commercial applications, there are additional complexities to potential changes in this area that could lead to costly and unintended consequences for both the Government and industry.

## IV. Section 824(b) Does Not Sufficiently Balance the Interests of the Government and Industry.

There is a need to balance the requirements for increased competition with the value of continued access to private sector innovation to support DoD missions. The 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. These concepts were all underscored in the Major Weapons Systems Reform Act, which required that the DoD address better upfront acquisition planning to include the acquisition (and payment for) data rights. This requirement addressed the concern that the DoD had not made the necessary determination to purchase data rights in some cases where it would have made subsequent competitions easier, either because of a lack of priority of reducing life cycle costs or

because of decisions to avoid the costs of acquiring and maintaining data in the short term. ARWG agrees that better upfront acquisition planning and the early determination of data rights needs for subsequent competitions and sustainment phases is a reasonable Government objective. However, ARWG does not agree that the treatment of indirect costs such as IR&D and B&P should in any way change the fundamental nature of the Government's license rights in technical data.

V. Section 824(c) Imposes an Unreasonable and Costly Administrative Burden Unless Exercised by the Secretary of Defense Only Under Limited and Exceptional Circumstances.

Before the enactment of Section 824, the DoD's ability to challenge an asserted use or release restriction with respect to technical data under 10 U.S.C §2321(d) was limited by the three-year period set forth in subparagraph (2)(B). Accordingly, contracting officers were unable to challenge an asserted use or release restriction after the later of two dates – a date certain. This enabled contractors to establish data retention policies that both met statutory requirements and were cost efficient.

In accordance with the modified 10 U.S.C §2321(d)(2)(C), the three-year period set forth in 10 U.S.C §2321(d)(2)(B) no longer applies to cases in which “the Secretary finds that reasonable grounds exist to believe that a contractor or subcontractor has erroneously asserted a use or release restriction...” It is unclear whether or not the exception set forth in subparagraph (d)(2)(C) will be exercised only: (i) by the Secretary of Defense, and (ii) in limited, exceptional circumstances. If the exercise of such rights is not limited as discussed in (i) and (ii) above, then this statutory change presents an unreasonable and costly administrative burden on contractors to maintain indefinitely records sufficient to justify the validity of asserted use or release restrictions. Moreover, if this exception is applied broadly, it would appear to undercut the three-year limitation entirely because fundamentally, all challenges question whether a contractor's assertions are justified, i.e., are erroneous. Finally, even if this exception to the three-year challenge period applies only to future data rights challenges, the Government could reap a “windfall” in rights in data pertaining to older programs if the contractor did not happen to anticipate this change and thus, did not retain sufficient records to meet its burden of proof in the challenge.

The DAR Council routinely delegates the rights and obligations delegated to the Secretary of Defense in 10 U.S.C §2320 and 10 U.S.C §2321 to contracting officers. If 10 U.S.C §2321(d)(2)(C) is delegated to contracting officers, then contractors' data retention policies must take into consideration the risk that contracting officers will look for “reasonable grounds” to challenge asserted use or release restrictions made under each and every Government contract. This will likely result in an increased number of contracting officer challenges prior to the sustainment phases of major weapon system and subsystem programs. Instead, ARWG encourages Congress either repeal this Section or to limit 10 U.S.C §2321(d)(2)(C) challenges to those made only by the Secretary of Defense under limited and exceptional circumstances.

**RECOMMENDATION:**

ARWG recommends the repeal of Section 824(b) of the 2011 National Defense Authorization Act (P.L. 111-383), retroactive to its effective date, and either the repeal of Section 824(c), retroactive to its effective date or clarifying revisions limiting the challenges which can be made under 10 U.S.C §2321(d)(2)(C).

## **ISSUE: MAINTAINING GOVERNMENT ACCESS TO COMMERCIAL TECHNOLOGIES, PROCESSES AND PRODUCTS**

The proliferation of Government-unique requirements imposed on companies interested in selling commercial products or services to the Government undermines the sound public policy objectives of ensuring Government access to commercial technologies, services, and supplies, collectively referred to as "commercial items." Congress has for at least two decades recognized that Government acquisition of commercial items helps to increase competition, reduce costs and provide the most effective approaches to supporting agency missions.

### **PROBLEM STATEMENT:**

The importance of the Government's ability to access the commercial marketplace for items and services has been well established, and was significantly bolstered with the enactment of such laws as the Federal Acquisition Streamlining Act of 1994 (FASA), the Federal Acquisition Reform Act of 1996 (FARA), and the Services Acquisition Reform Act (SARA) of 2004. Among the purposes of this legislation was the transformation of the Federal acquisition system from one based on acquiring Government-unique products under detailed design or performance specifications to one embodying a preference for the acquisition of commercial items, including services and technologies, whenever practicable using more streamlined commercial practices.

The Government Accountability Office (GAO) and other Government and academic sources have issued several reports documenting the benefits of using commercial items. Those benefits include:

- Access to and more rapid deployment of state-of-the art technologies
- Integration of the defense and commercial industrial bases to benefit the Nation's security and economy
- Savings of research and development expenditures; leverage state of the art technologies developed in the commercial marketplace; reduced economic risk associated with developing new DoD unique items
- Opportunities for increased competition; availability of market research and market prices as a price analysis tool
- Utilization of open industry standards
- Parts obsolescence managed by suppliers

Nevertheless, over the last decade, there has been an erosion of the Government's ability to access the commercial marketplace, resulting from various legislative and regulatory changes. These changes have been designed to address specific issues rather than systemic shortcomings, such as alleged misuse of authority and Contracting Officer capability to determine price reasonableness. Some of these have been more narrowly targeted, such as ensuring that major weapons systems can be treated as commercial items only under strict conditions. Others have been broader in scope and impact, such as legislation reversing the presumption of development at private expense (with respect to allocation of data rights), or tying the use of commercial authority to the provision of cost-related data to support a contracting officer's ability to establish price reasonableness.

For example, a DPAP policy letter of May 31, 2007, emphasizes the requirement for contracting officers to obtain cost or pricing data if the Truth in Negotiations Act (TINA) applies. When TINA does not apply, contracting officers are to obtain "whatever information or data is necessary to determine a fair and reasonable price." DPAP also has been conducting Contract Pricing Workshops at numerous locations across the country to emphasize use of these cost tools.

Another example is Section 802 of the FY2007 NDAA (P.L. 109-364) that reversed the 10 USC 2321(f) presumption of development at private expense for all commercial items, unless a contracting officer had evidence to the contrary. Fortunately, the prior presumption was partially restored the following year, but only as applied to Commercial Off-the-Shelf (COTS) items – but not for all commercial items. Sections 805 and 815 of the FY2008 NDAA (P.L. 110-181) restrict the use of commercial contracting procedures for commercial services, and for major weapon system subsystems, components and spare parts that meet definition of commercial items, by requiring a contractor to submit cost or pricing data if needed for a determination of price reasonableness. The contracting officer's request may include information on labor costs, material costs, and overhead rates. For the first time, a contractor supplying a commercial item may be required to submit not only information about its pricing, but also about its costs. While this change is applicable only to a limited set of purchases, it represents a fundamental change in the way DoD interacts with companies supplying commercial items and services. It also departs from common commercial practices.<sup>1</sup>

Another recent example of a unique government requirement is the amendment to the Federal Funding Accountability and Transparency Act (Public Law 109-282, 31 U.S.C. 6101 note) that imposes a requirement for all prime contractors and subcontractors on any contract above \$25,000 to provide information for posting on a publicly accessible database of executive compensation unless the contractor or subcontractor supplies equivalent information to the SEC.

An additional example includes the mandated 3% withholding of payments on all government contracts to be imposed on January 1, 2012 under section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), P.L. 109-222.

On the regulatory side, the number of Federal-unique clauses that can be imposed in a FAR Part 12 prime contract has grown from the original dozen to about 50 provisions (FAR 52.212-5). ARWG has written about this creep several times in the past, and in Section 821 of the FY2008 NDAA, Congress partially addressed this issue, tasking DoD to develop a plan to minimize such unique provisions. This legislative mandate will help refocus attention on simplifying the terms of contracts for commercial items directly procured by the Government. Nonetheless, access to the commercial marketplace will remain markedly better at the subcontract level, due to the very limited (albeit growing) number of clauses that are required to be flowed down in a FAR Part 12 subcontract to a commercial subcontract or from a prime contractor. This practice shows that the primary means to access the commercial marketplace remains through a traditional government contractor.

On a related issue, the recent FAR interim rule on the National Labor Relations Act posters has also been applied to commercial items and COTS items. The rule says "During the term of this contract, the contractor shall post an employee notice...in and about its plants and offices where employees ...engage in activities relating to the performance of the contract." It is unclear how this is supposed to work for a COTS procurement. If the item is "off-the-shelf," what is the "term of the contract," and where are the employees performing the contract?

#### **NEED FOR CHANGE:**

Inserting Government-unique clauses in contracts discourages commercial companies from doing business with the U.S. Government. This unnecessarily limits competition at the prime contract level and

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<sup>1</sup> We realize that commercial companies sometimes ask for and receive various types of cost information from other commercial companies seeking work. However, that data is often quite limited or its scope is negotiated; audits are rare, and its submission does not entail exposure to large fines and potential criminal liability.

discourages small and innovative businesses from being prime contractors. The flowdown of these requirements to suppliers likewise discourages companies from participating in these contracts at any tier when the cost of meeting the cumulative set of government-unique requirement exceeds the benefit, and potentially increases operating costs to the extent that products or services become less competitive in the commercial marketplace.

U.S. manufacturers and suppliers of commercial items are being challenged as never before to compete internationally as industry supply chains become global. Savings from process improvements are becoming more important than ever. Separate supply chains, separate business segments, and separate manufacturing facilities just for performing U.S. government work are increasingly expensive to maintain, driving up prices to the U.S. government and discouraging new market entrants. If achieving competitiveness at the global level becomes threatened, some contractors will follow those who have already chosen to leave the DoD marketplace, rather than lose out to competitors who do not incur such costs in the global commercial market. There is no way to assess how many businesses choose to never enter the DoD market in the first place. Manufacturers and services companies that choose to remain are increasingly being forced to segregate the operations supporting their commercial customers from their federal government customers. The increased costs could be prohibitive for DoD and could result in significant delivery delays. Another unfortunate consequence might be the decision by commercial manufacturers to halt direct sales to the Federal Government and instead market their products through distributors or integrators whose markets are limited to Government customers who cause the increased indirect costs such firms incur. With higher costs and increasing risks, commercial market pricing will often not be offered to Government customers.

Contracting officers are resisting making commercial item procurements for hardware or services that is of a type sold or offered for sale in the commercial marketplace out of concern that an auditor or other oversight entity will criticize their judgment. It would be an unfortunate reversal of the reforms enacted in the mid-1990s if our warfighters were to be denied timely access to state-of-the-art commercial technology due to unnecessary administrative constraints resulting from a contracting officer's decision to avoid commercial item contracting out of a fear of criticism. This situation is all the more unnecessary given that the key issues on pricing of commercial items and services have been effectively addressed by Congress in Sections 805 and 815 of the FY2008 NDAA (P.L. 110-181) discussed above.

In 2008, the Department of Defense Panel on Contracting Integrity recommended that the commercial item definition in title 41 eliminate the phrase "of a type" and "offered for sale" from the definition of commercial item. The Panel made a similar recommendation in 2009. The recommendation was an attempt to address a) the lack of systematic commercial item determinations by contracting officers; b) inadequate documentation supporting commerciality determinations; and c) price reasonableness determinations that were not always sufficiently supported for non-competitive actions. In our opinion, the causes were that acquisition officials misapplied existing definitions in order to take advantage of the less restrictive process requirements for acquiring commercial items, and acquisition officials seemed to lack the training and skills to perform price analysis of commercial items in the absence of cost data.

ARWG strongly opposes this narrowing of the definition of commercial item for a number of reasons. This change would disrupt government supply chains and disadvantage some key players, including small businesses. The change would mean that businesses that did not sell their supplies or services commercially could not be awarded GSA multiple award contracts or any other contracts restricted to "commercial items." Many of the companies that regularly do business with the government do so through separate divisions or segments set up and administered to meet government unique requirements, such as cost accounting standards, control and maintenance of cost or pricing data, and reporting requirements. Some companies, particularly small companies, do only governmental work. Nonetheless, they often sell products and particularly services that are of a type sold commercially.

For instance, an HVAC contractor may market itself exclusive to as a prime or subcontractor to work on local government facilities, yet the products and services it provides are similar to those products and services of an HVAC contractor who serves commercial and industrial customers. Another HVAC contractor may sell commercial and industrial type services exclusively to government customers and also sell services to individual home owners. Market research can be used to determine price and contract terms and conditions consistent with those in the commercial marketplace. If “of a type” were eliminated from the definition, this successful government contractor could not compete for commercial item type work and could not keep its place on the GSA schedule contract.

As noted above, requirements for determining commerciality and price reasonableness have been addressed comprehensively by Congress, which added restrictions on the designation of programs as commercial items and new requirements on provision of cost data for pricing of commercial services in legislation passed since 2008.

Given the impacts of the various legislative and regulatory changes that have occurred since FASA and FARA, ARWG believes additional changes are warranted to restore and enhance the Government’s ability to access the commercial marketplace for its needs.

#### **RECOMMENDATIONS:**

ARWG recommends that Congress enact the following changes to address the issues cited above that are currently acting as impediments to Government access to the commercial marketplace:

- Congress and the Executive branch should: refrain from imposing new government unique clauses in the Federal Acquisition Regulations; mandate a study by the Congressional Research Service on the extent and cost of existing government unique clauses using the goals expressed Executive Orders 13563 as a yardstick; and, require all new government unique clauses be subject to a review and scoring by the Congressional Budget Office to determine the cost of their implementation.
- Fully restore the original presumption of development at private expense in 10 U.S.C. 2321(f) for *all* commercial items, not just COTS, as existed before the FY2007 NDAA was enacted. Furthermore, Congress should strengthen the provision in 10 U.S.C. 2320 (a)(2)(F) that specifically prohibits DoD from mandating that contractors provide unlimited rights to data as a condition of responsiveness to a request for proposal, especially those for the acquisition of commercial items at either the prime or subcontract levels.
- Amend the Federal Funding Accountability and Transparency Act (Public Law 109–282, 31 U.S.C. 6101 note) to exempt contractors and subcontractors supplying commercial items from the reporting requirements, especially those on executive compensation.
- Direct OMB to amend the FAR, and DoD to amend the DFARS, to reflect that only those government-unique clauses currently required to be flowed down in FAR Part 12 subcontracts are required to be incorporated into FAR Part 12 prime contracts, as well. DoD should continue to develop its plan for minimizing unique requirements in commercial contracts to address other non-commercial mandates, such as compliance with MIL-STD-130, defining unique identification marking and registration requirements.

- Direct DoD to adhere to the statutory preference for acquiring commercial items using existing flexibilities in the law and to train their people how to perform effective market research and price analysis.
- Resist any further efforts to restrict the definition of commercial item or service in recognition of the new authorities granted to contracting officers to address price reasonableness concerns.

## **ISSUE: SUSPENSION AND DEBARMENT: REQUIRE NOTICE BEFORE LISTING**

The suspension and debarment system is an important element of sound federal contracting policy and is designed to prevent the award of federal contracts to persons and businesses not presently responsible under the standards articulated in FAR 9.406-2 and 9.407-2. This is accomplished by placing the person or company on the Excluded Parties List (“Listing”). Once Listed a person or business may no longer receive awards of contracts, tasks or delivery orders and all of its customers begin to question its trustworthiness. Listing must thus be subject to due process protections commensurate with the harm that flows from the act.

Currently, the FAR permits an agency Suspension and Debarment Official (SDO) to issue, in the case of a debarment, a notice of proposed debarment, and in the case of a suspension, a notice of suspension, with no prior notice to the person or business. Upon issuance of either notice, the person or business is “Listed” which means it cannot be considered for award of any contract, task or delivery order by any agency of the federal government. The SDO’s are not required to inform or even ask the person or business for its view of the circumstances that the SDO considers may justify suspension or debarment or what steps the person or business has taken to correct the problem. The SDO is not required to determine other agencies’ interest and take that into account before Listing a person or business.<sup>2</sup> Too often, it is not until after the SDO Lists the person or business that the person or business is even informed that Listing had been contemplated. The use of sudden and unexpected Listing can dramatically amplify the risk of inappropriate or unnecessary Listing. Just Listing causes severe, long lasting reputational damage, and will affect award of commercial, state and local, and international contracts as long as the company is Listed. Consequently, ARWG joins others in asking the process be changed to require 30 day notice prior to Listing unless persons or property could be potentially endangered by continuing to contract with the business or person proposed to be Listed.

### **DISCUSSION:**

ARWG anticipates agencies may be more aggressive in the utilization of their authority to suspend and debar non-responsible contractors<sup>3</sup> and some in Congress seem to be urging the same course.<sup>4</sup> We observe that such initiatives are sometimes accompanied by calls for the Government to stop doing business with “criminals” or to suspend or debar to make contractors “accountable.”

Debarment/Suspension is not intended to be punishment, rather it is a prophylactic measure to protect the government from doing business with a person or business that is not *presently* responsible. Agencies should also contemplate with care Listing businesses because that will materially adversely impact employees and investors who may be victims of the negligent or even willful bad acts of employees just as the contracting agency is. The person or business may be unaware of these bad acts or these acts may be beyond the control of the business or person.

Suspension and debarment are not punishments for businesses that defraud the government or commit other crimes. The Federal Acquisition Regulation makes this point explicitly in subsections (a) and (b) of 9.402:

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<sup>2</sup> Although there is an informal agreement among the SDOs to check with the agencies with the most significant contracts with the person or business before acting on the matter, this agreement is not binding upon any of the SDOs

<sup>3</sup> Office of Inspector General, Department of Homeland Security, *DHS’s Use of Suspension and Debarment Action for Poorly Performing Contractors*. OIG-10-50. February 2010.

<sup>4</sup> Senator Bernie Sanders, Release: Pentagon Spent Billions on Contractors that Committed Fraud, February 2, 2011, <http://sandersonsenate.gov/newsroom/news/?id=2b80052e-9401-4b96-989c-84d506b76deb>

a) Agencies shall solicit offers from, award contracts to, and consent to subcontracts with responsible contractors only. Debarment and suspension are discretionary actions that, taken in accordance with this subpart, are appropriate means to effectuate this policy.

(b) The serious nature of debarment and suspension requires that these sanctions be imposed only in the public interest for the Government's protection and not for purposes of punishment. Agencies shall impose debarment or suspension to protect the Government's interest and only for the causes and in accordance with the procedures set forth in this subpart.

Those who criticize the practice of awarding new contracts to companies that may have transgressed in the past often fail to take into account the purpose of suspension and debarment. The actions required by SDOs are intended to lead to corrections that make a company "responsible" thus protecting the government from dealing with persons or businesses who are not responsible and ensuring potential competitors are not needlessly excluded. Once a SDO assesses corrective actions as adequate, there is no reason to withhold the award of new contracts and task orders except to punish the organization. It is critical that Congress keep this firmly in mind when evaluating new proposals to "reform" or improve the suspension and debarment process. Too often critics seek to punish companies that have had employees transgress in the past. In these critics' minds, the company is the criminal and should not continue receiving contract awards. At times this perspective appears to be based on a conspiracy theory that each contractor is out to bilk the government when in fact the interests of the contractor are to perform each contract well to help assure it is paid for that work and gets more work in the future.

Thus when a SDO determines that the company's corrective actions have been adequate to make doing business with that company reasonable, these critics are not satisfied because the company still receives government funds. While there is no guarantee that no one employed by the company will violate the rules ever again, the company has reasonable processes and policies in place to mitigate this risk to keep the company as a supplier.

Companies fire employees who commit serious offenses for betraying the trust of their employers. SDOs debar such individuals from obtaining government contracts for betraying the government's trust. These deviant employees victimize the employer organization by violating corporate policies and the employees' duties to the organization. Nonetheless, their employers often not only pay for damages done but also for the costs of government investigations. When properly administered, the suspension and debarment process does not injure organizational victims out of all proportion to the injury an employee causes.

One should also remember that if an organization is debarred, every employee will suffer. When the government is a business's main customer, much of the business's innocent workforce will become unemployed if the company is debarred and thus driven out of business. Even when the government is not the main customer, a government suspension, and even more so, a debarment will materially damage a business and its employees. Congress should reject calls to ignore the distinction between persons who commit wrongs and the businesses that employ them.

Because of the potentially devastating government-wide impact on the mission of agencies and on persons or businesses, ARWG believes that notifications of suspension or potential debarment should include an opportunity to respond to the merits of any such action and to provide a mitigation plan before the person or business is Listed in almost every case. The Administrative Conference of the United States

made such a recommendation fifteen years ago.<sup>5</sup> These recommendations are also consistent with discussions of suspension and debarment considerations by Professor Ralph Nash in the July 2009 Nash and Cibinic Report, ¶ 26, *SUSPENSION AND DEBARMENT: Protecting The Government By Denying Due Process To Contractors*, and by Todd J. Canni, *Shoot First, Ask Questions Later: An Examination and Critique of Suspension and Debarment Practice Under the FAR, Including a Discussion of the Mandatory Disclosure Rule, IBM Suspension, and Other Noteworthy Developments*, Vol. 38 No.3 Public Contract Law Journal Pg 547-609 (Spring 2009). Likewise at its 2011 mid-year meeting the American Bar Association approved the following resolution<sup>6</sup>:

RESOLVED, That the American Bar Association opposes the adoption of legislation by Congress that would mandate suspension or debarment of a single entity or class from bidding on or receiving federal contracts and grants without regard to the existing regulatory framework, which provides for agency discretion in suspension and debarment determinations.

The discussion in advance may eliminate the need for Listing the organization at all. Such notice may well allow corrections that avoid the collateral damage Listing will cause to the government and the person or business. Nonetheless there may be occasions when the public interest dictates that the person or business must be Listed without prior notice. ARWG proposes that if public health or safety likely would be endangered if the person or business continued to do government business, then a suspension could take effect upon issuance.

ARWG would also support making the suspension and debarment process more transparent and ensuring debarment offices are properly resourced but would be concerned if a SDO's job performance would be determined by simply noting how many debarment actions had been taken.

#### **RECOMMENDATION:**

- ARWG recommends that Congress direct that the FAR be revised to prohibit agencies from Listing a person or businesses without prior notification and an opportunity to be heard unless the SDO determines that allowing the person or business to be awarded new contracts would present an unacceptable risk to the safety of persons or property. Agencies could continue to use a notice of proposed debarment and suspension notices, but a person or business could not be Listed until the SDO reviewed any timely response from the person or business unless the DBO made a written determination that persons or property would likely be threatened without immediately Listing the person or business.
- Congress should also require the agency SDO initiating a suspension or proposed debarment to notify all other SDOs of the proposed action. Recipient SDOs shall notify contracting offices within their

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<sup>5</sup> Recommendation 95-2, Debarment and Suspension from Federal Programs, 1 C.F.R. 305.95-2 (1995) < <http://www.law.fsu.edu/library/admin/acus/305952.html>> last accessed 02/16/2011. The recommendation states in pertinent part:

As also noted, suspensions become effective immediately. The suspended respondent may, after the fact, submit written comment and information to the debarring official opposing the continuation of the suspension. In some cases, the lack of advance notice is necessary to allow an agency to protect the integrity of its contracting or nonprocurement program. In other cases, however, it may be appropriate to provide advance notice to the potential respondent that a suspension or proposed debarment may be forthcoming. In fact, some agencies do send what are in essence "show cause" letters in certain situations. In cases where the interests of the government would not be substantially adversely affected by providing advance notice of a suspension of proposed debarment, the Conference encourages agencies to provide such notice.

<sup>6</sup> Found at <http://www.abanow.org/2011/01/116/> last visited March 8, 2011.

agency of the proposed action. The notice should request that any interested agencies contact the issuing SDO within the same 30 days provided the person or business. The SDOs shall determine which agency SDO should take the lead. After the person or business responds to the notification of suspension or proposed debarment, the lead agency shall promptly determine whether Listing is necessary to protect the government's interest while the debarment or suspension action continues.

- The lead agency SDO should be required to consider, based upon discussions with other interested agencies, whether any agency is likely to waive the suspension or debarment if imposed. Where the lead agency determines that suspension or debarment is necessary but learns that a waiver by other agencies would occur, the lead agency should not immediately exclude the person or business. Rather, the lead agency should offer the person or business the opportunity to enter into an administrative agreement, whereby the person or business agrees to implement relevant compliance measures to prevent reoccurrence of the cause for suspension or debarment and refrain from competing for new awards with the exception of agencies that have demonstrated compelling reasons to continue their business relationship.