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March 25, 2020

The Honorable James Inhofe
Chairman
Senate Committee on Armed Services
Russell Senate Building, Room 228
Washington, DC 20510-6050

The Honorable Jack Reed
Ranking Member
Senate Committee on Armed Services
Russell Senate Building, Room 228
Washington, DC 20515-6050

Dear Chairman Inhofe and Ranking Member Reed:

As the President and CEO of the largest U.S. defense industry association representing over 1,700 small, medium, and large-sized contractors and subcontractors, I am writing to express our members' support for a legislative proposal that would establish a uniform policy for the Department of Defense (DoD) regarding the application of profit or fee to all categories of allowable cost in competitive procurements.

This legislative proposal would explicitly allow a contractor to propose profit or fee on all categories of allowable costs in responding to a solicitation for a competitive procurement. This legislative proposal would apply this new requirement to both fixed-price type and cost-reimbursement type contracts resulting from a competitive procurement. Further, this requirement would apply to all allowable costs regardless of whether those costs were incurred on a prime contract or a subcontract at any tier. This legislative proposal has been previous shared with your staff and is attached to this letter for your review and consideration.

This legislative proposal is a necessary corrective measure because DoD components have allowed contracting officers broad discretion to artificially limit contractor profit or fees by labeling certain categories of cost or contract line items (CLINs) as "non-fee bearing" in the solicitation. It is the routine practice of some DoD contracting officers to publish solicitations for competitive procurements with language that explicitly states certain categories of costs or CLINs will be "non-fee bearing." These proscribed categories of cost may include travel, material, subcontracts and "other direct" costs. However, if these costs are limited to "reasonable actual" expenses plus a G&A or other indirect rates, the contractors' fully burdened expenses may not be recoverable under the contract.

Current DoD practices negatively impact the ability of small business to compete as primes. Without the ability to recoup a sum equivalent to fully burdened expenses plus a reasonable profit or fee, a small business contractor may be deterred from entering into the competition at all. These DoD practices stand in sharp contrast with the purely commercial marketplace. In the commercial marketplace, small businesses that cannot recover their true costs- and make a reasonable profit in addition- will not stay in business for long. Additionally, different-sized contractors may categorize different costs in different ways. Depending on that variation, one contractor may not be as affected by the assignment of certain categories of cost or CLINs as non-fee bearing as another contractor, particularly a small business. Such a practice distorts competition by creating an artificial advantage based on categorization of costs alone. Additionally, all prime competitors will face additional costs associated with developing, tracking and separately invoicing non-fee bearing CLINs or cost categories. However, these additional costs present a tougher burden to small business prime competitors, who do not have the same internal accounting and compliance resources that medium or large business prime competitors do.

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Current DoD practices disproportionately hurt small businesses in the defense supply chain. In some instances, the contracting officer may require the flowdown of fee limitation throughout the supply chain. Even if the contracting officer does not explicitly require the flowdown, prime contractors may have no choice but to flowdown the fee limitations to the supply chain, on their own accord, in order to make the business case to engage in the competition. In either case, the practice has a particularly deleterious effect on small business subcontractors in the supply chain. Flowdown of these fee limitations constricts the cash flow vital to the continued health of these small businesses.

Finally, these practices are contrary to Departmental policy on non-competitive procurements. In 2002, the Department changed its profit policy to include G&A costs in the cost base for computing profit or fee in a non-competitive procurement. The Department explained its rationale for making this change as follows: "Most other agencies include G&A in computing profit objectives, and this was DoD policy until 1986. We believe that adding G&A into the cost base results *in consistent treatment of all allowable costs when computing profit objectives, and that G&A expenses should not be subject to less favorable treatment than other types of contract costs."*[1] (emphasis added). These changes are reflected in boxes 18, 19 and 20 of the weighted guidelines form (DD Form 1547).[2] The boxes reflect the fact that, in a non-competitive environment, the contracting officer is required to apply profit or fee across all categories of allowable costs in the base.

Enacting this legislative proposal is a top priority for NDIA small business member companies. NDIA strongly encourages the Senate Armed Services Committee to include this legislative proposal, as currently drafted, in the Chairman's mark for the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2021.

Congress has long recognized that competition is the key to acquiring defense supplies and services in the "most timely, economic and efficient manner."[3] Market forces are the primary means to incentivize industry to superior performance at reasonable prices. Contractors' profits or fees should be determined at the level of overall price and set by competition subject to these market forces.

We hope you will consider NDIA's support of this vital legislation in your deliberations on the FY21 NDAA. If you or your staff have any questions, please contact Kea Matory, Director of Legislative Policy, at kmatory@NDIA.org or (703) 247-9478.

Sincerely,

Herbert J. Carlisle
General, USAF (Ret)
President & CEO
NDIA

Mary Lockhart
President & CEO
PEMDAS Technologies & Innovation
Chair, NDIA Small Business Division

[1] DFARS Case 2000-D018, "Changes to Profit Policy, " FR 20689 (April 26, 2002), available at https://www.gpo.gov/fdsys/pkg/FR-2002-04-26/pdf/02-10096.pdf.

[2] *See* Department of Defense, "Record of Weighted Guidelines Application," DD Form 1547 (July 2002), available at http://www.dtic.mil/whs/directives/forms/eforms/dd1547.pdf.

[3] *See* Section 2721 of the Competition in Contracting Act, Pub. L. 98-369 (July 18, 1984).