

# COUNCIL OF DEFENSE AND SPACE INDUSTRY ASSOCIATIONS

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September 29, 2000

CODSIA Case No. 11-00

Ms. Amy Williams  
Defense Acquisition Regulations Council  
OUSD (AT&L) DP (DAR)  
IMD 3D139,  
3062 Defense Pentagon  
Washington, DC 20301-3062

Dear Ms. Williams:

Subject: DFARS Case 2000-D018; Changes to Profit Policy

The Director of Defense Procurement has proposed amendments to the Defense Federal Acquisition Regulation Supplement (DFARS) to modify the Department of Defense (DOD) implementation of the statutory requirement for a structured profit policy in order to more closely align the weighted guidelines with current DOD policy and mission (DFARS Case 2000-D018). The proposal would reduce and eventually eliminate the reward for additional facilities investment and increase the emphasis on performance risk to encourage contractor cost efficiency. The undersigned members of the Council of Defense and Space Industry Associations (CODSIA) have reviewed the proposed rule (65 Fed. Reg. 45574-45579, dated July 24, 2000), and provide the following comments for your consideration.

Formed in 1964 by industry associations with common interests in the defense and space fields, CODSIA is currently composed of eight associations representing over 4,000 member companies across the nation. Participation in CODSIA projects is strictly voluntary; a decision by any member association to abstain from participating in a particular activity is not necessarily an indication of dissent.

- 1. Modernization Investments:** A meaningful incentive should be retained in the guidelines for efficient asset utilization and equipment modernization or replacement. DOD should continue to encourage investments in new and more efficient production equipment. The existing weighted guidelines policy provides profit credit consideration for undepreciated (new) equipment. The new proposed policy will result in reduced weighted guidelines profits for companies that invest heavily to modernize equipment for the production of DOD hardware – an outcome that would not be beneficial for the Department. Quantitative analysis by one of our member companies shows that the proposed change for a company

that is heavily facilitized could reduce profit levels. Consideration should be given to continuing to provide some profit weighting for efficient asset utilization, or to permit contracting officer discretion on whether to encourage modernization via profit consideration.

If DOD decides to eliminate completely the reward for facilities investment, it should increase the potential reward for cost efficiency beyond the 4 percent proposed maximum, with a minimum amount large enough to make the facilities investment that generates the savings a prudent use of corporate investment. Otherwise, the policy will not achieve the desired results.

2. **Performance Risk:** We agree that increasing the emphasis on performance risk is appropriate and consistent with the Government emphasis on contractor past performance. We believe that contractors who perform well should be recognized in the weighted guidelines calculations. As such, we propose that the low end of the performance risk range remains the same, but that the maximum range be increased to recognize a contractor's history of excellent performance. Additionally, performance based specifications, Total System Performance Responsibility Clauses, or effort involving integration/development of complex equipment and software shift risk to the contractor and accordingly, should be addressed as factors which warrant a maximum profit evaluation.
3. **Contract Type Risk:** The proposed reduction of 0.5% in Contract Type Risk should be eliminated from the rule. We believe that there is no reason for decreasing contract type risk percentages and recommend that the current DFARS should be retained without change.
4. **Technology Incentive.** The incentive as drafted does not apply to follow-on production contracts. Industry should be able to obtain recognition in production when innovative technological solutions have been incorporated. Please refer to our prior comments on this subject submitted on July 21, 2000, DFARS Case 2000-D300.
5. **Cost Efficiency Incentive:** The new cost efficiency factor has the potential of being the most significant change in the weighted guidelines policy. However, the basis on which it will be applied needs clarification. Without this, it is too subjective and as a result, we are unable to estimate its impact on profit opportunity. Certainly the need to address both a short-term and long-term focus of cost efficiency is an important area for clarification. Currently, applicability of this factor appears to be limited by direction to the contracting officer to "...evaluate the benefit the contractor's cost reduction efforts will have on the pending contract." (proposed DFARS 215.404-71-5(a), emphasis added.) This would ignore a contractor's success in addressing long-term cost reduction and cost avoidance throughout the company. It also ignores the fact that many long-term cost reductions involve non-recurring up-front costs, having effects over time and over many contracts. To achieve the desired result of cost reduction (direct and indirect) in the context of total ownership and life cycle cost, the government's focus in this area should be broadened, and criteria clarified to explain when use of the cost-efficiency factor would be appropriate. Experience with other

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similarly subjective weighted guidelines factors indicates that contracting officers frequently elect to give no extra markup. There needs to be a stronger DOD admonition that cost efficiency should be rewarded.

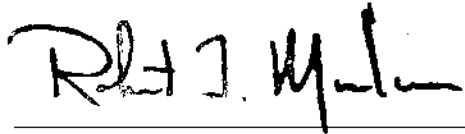
DOD's willingness to consider changes in the weighted guidelines is a positive step. However, if the above changes are not addressed in the final rule, the rule will reduce profit for companies that are producing hardware for the DOD.

This complex issue deserves expedited attention and we believe that there should be further consideration of the financial implications of the proposed rule before it is issued in its final form. Such analysis would best be accomplished by a joint government and industry working group at the earliest opportunity. We stand ready to assist in forming such a group.

Thank you for the opportunity to provide comments on this very important proposal. If there are any questions or if we can be of further assistance, please contact Patrick Sullivan, CODSIA Project Officer, at (202) 371-8522.

Sincerely,

(SEE ATTACHED CODSIA SIGNATORIES)



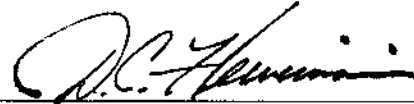
Robert T. Marlow  
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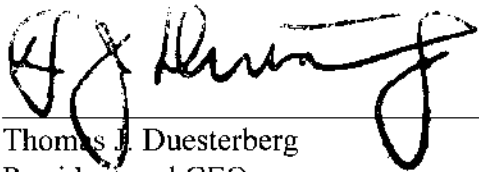
Lorraine M. Lavet  
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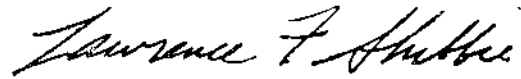
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