

COUNCIL OF DEFENSE AND SPACE INDUSTRY ASSOCIATIONS

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April 19, 1999
CODSIA Case No. 2-99

Ms. Laurie Duarte
General Services Administration
FAR Secretariat (MVR)
Room 4035
1800 F Street, NW
Washington, DC 20405

Subject: Progress Payments and Related Financing Policies (FAR Case 98-400)

Dear Ms. Duarte:

The undersigned members of the Council of Defense and Space Industry Associations (CODSIA) appreciate the opportunity to offer comments on the proposed rule published in the Federal Register on February 10, 1999 (Vol. 64, No. 27). 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 firms 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.

The FAR Council proposed a number of revisions to FAR Part 32 that were developed by a special interagency team which had been formed at the direction of the Director of Defense Procurement. The proposed revisions were as follows:

- Increase dollar threshold for progress payments for large businesses from \$1 million to \$2 million (single contract or group of contracts).
- Where a group of contracts exceeds \$2 million, limit progress payments to contracts and/or orders that exceed the simplified acquisition threshold.
- Eliminate paid cost rule and require, instead, that payment be made in the ordinary course of business.
- Permit subcontractors to receive commercial financing payments (FAR 32.2) or performance-based payments (FAR 32.10).
- Remove limitation on general and administrative (G&A) expenses.

- Remove requirement for quarterly statements under price revision or price redetermination contracts.
- Permit performance-based payments on contracts for research and development and contracts awarded through competitive negotiation procedures.
- Emphasize that performance-based payments are the preferred method of financing.
- Clarify the relationship between the loss ratio factor and fair value test.
- Delete authorization for flexible progress payments and different rates for foreign military sales (FMS) contracts.

As the Federal Register stated, these reforms have been under active consideration since 1997. CODSIA and its member associations were pleased to have been given the opportunity on a number of occasions to present private industry's views and offer suggested changes.¹ While we generally support the revisions proposed by the FAR Council, there are some issues which merit further consideration.

Increased Dollar Threshold

We understand the need for increasing the dollar threshold. However, we recommend that the term, "Simplified Acquisition Threshold" in 32.104 (d)(1) be changed to read "\$100,000." We are concerned that tying the progress payment threshold to the simplified acquisition threshold would result in an automatic increase in the progress payment threshold whenever the simplified acquisition threshold is increased.

Paid Cost Rule

We support eliminating the paid cost rule and were pleased to see that the FAR Council adopted our recommendations to include other clauses that apply the paid cost rule (i.e., "Allowable Cost and Payment" at FAR 52.216-7 and "Payments under Time-and-Materials and Labor-Hour Contracts" clause at 52.232-7). However, another clause that should be included is the "Payments of Allowable Costs Before Definitization" clause at FAR 52.216-26. These changes will necessitate revisions to related forms and instructions.

¹ See also CODSIA letter to Progress Payment Rewrite Team, June 10, 1997; Aerospace Industries Association (AIA) letter to Progress Payment Rewrite Team, April 6, 1998; and Electronic Industries Alliance letter to Progress Payment Rewrite Team, April 7, 1998.

We recommend that a policy decision be made that it is in the best interests of the Government to allow contractors to implement this important reform measure on all contracts (both existing and new), as quickly as possible. Contracting officers should be instructed to amend existing contracts, without consideration, upon the request of the contractor.² This should be accomplished by issuing guidance in the final rule or agency directives. The Government benefits from the savings realized in streamlined billing systems through eliminating the extra steps that contractors must take to apply the paid cost rule, and eliminating Government audit and review of payment requests. If existing contracts are not amended, contractors will have to maintain and staff two billing systems until all such contracts have been completed.

Subcontractor Contract Financing

We agree with allowing prime contractors to use commercial financing payments (FAR Subpart 32.2) and performance-based payments (FAR Subpart 32.10) on subcontracts and to be fully reimbursed for such financing under the "Progress Payments" clause. We note, however, that although the proposed revision at FAR 32.110 suggests that this would be extended to cost reimbursement contracts, no revisions were proposed to the "Allowable Cost and Payment" clause (or similar clauses). We would agree with using the same reimbursement provisions as proposed for the "Progress Payments" clause. For the reasons noted above under the Paid Cost Rule section, agency management should instruct contracting officers to amend existing contracts without consideration.

Performance Based Payments

We have several concerns with the FAR Council's proposed revisions to the policies and procedures dealing with performance-based payments at FAR Part 32.10. Our major concerns are described below.

We do not accept that performance-based payments should be considered the "preferred method" of contract financing. Neither FASA, which first recommended the use of performance-based payments, nor the accompanying conference report made any reference to "preferred method."³ Interpreting FASA's phrase "whenever practicable" as an expressed

2 There are precedents for taking such action on existing contracts. It was permitted when the Truth in Negotiations Act threshold for certified cost or pricing was increased from \$100,000 to \$500,000 (see FAC 90-22, December 4, 1994). It was also permitted during the implementation of the Federal Acquisition Streamlining Act (see FAC 90-38, April 29, 1996).

3 FASA §2001 and §2051. See also Joint Explanatory Statement of the Committee of Conference.

preference is neither consistent with the legislative history nor appropriate in view of the practical problems that would result.

While CODSIA members believe that performance-based payments are an integral component of the contracting process, they are not appropriate for all contracting circumstances. As indicated in prior correspondence, member companies have been concerned with the difficulty in defining performance events, the risk of disrupting the entire cash flow of the contract when cumulative performance events are used, the potential for substantial outlays of unfinanced working capital over a long period before a performance event is reached, and the impact of significant contract modifications on performance events.⁴

Even if we accepted the view that performance-based payments are the "preferred method" of contract financing, the proposed rule includes no guidance to contracting officers on the conditions that should be present or the criteria that should be considered for the use of performance-based payments. We are especially concerned with the notion that the contracting officer must affirmatively decide that performance-based payments are impracticable before customary progress payments may be used (see Item #7 of Background section of the proposed rule). Absent appropriate guidance, we are fearful that performance-based payments will be misused and, ultimately, impair contract performance. We are concerned that contracting officers will consider compensating contractors by the traditional progress payments method only when they believe the performance based payment approach is contraindicated. We fear that contracting officers may construe the intent of language in the proposed rule (e.g., "ensuring consideration of performance-based payments") to imply that the use of performance-based payments is mandatory and that traditional progress payments should be used on an exception basis. We continue to believe, as apparently do the DAR/CAAC Councils, that performance-based payments should only be applied when the contractor agrees to their use (see FAR 32.10001(a)).

We accept that performance-based payment amounts should be commensurate with the value of the performance event or performance criterion (see FAR 32.1004-1(b)(3)(ii)). However, we are concerned with the requirement that contractor proposals for performance-based payments include a profile showing projected cash flow and contractor investment. We have reservations about the practical application of this guidance and the level of sophistication that will be required of contracting officers. Will the profile simply be a cash-flow analysis of payment streams or will the contractor be required to perform an analysis much like the one that was required under DoD's flexible progress payment methodology, which DoD does not support

4 CODSIA letter to Defense Acquisition Regulatory Council, Subject: Flexible Progress Payments (DFARS Case 98-D400), November 12, 1998 (CODSIA Case 11-98) and Aerospace Industries Association letter to Progress Payment Rewrite Team, April 6, 1998.

any longer? *We believe the intent of the requirement language is only to have the contracting officer review the expenditure profile for reasonableness.* We urge the DAR/CAAC Councils to move cautiously in this area and not impose this requirement until sufficient tools have been provided to contracting officers and contractors.

Another section of the proposed rule that needs further guidance is the provision on unreasonably low or negative level of contractor investment in the contract. Aside from the issue of how this will be determined, we are concerned with what is specifically meant by these terms. It is completely reasonable to expect at the outset of a contract that negative contractor investment might exist when compared to contract costs incurred, especially if the costs incurred in an accounting sense lag behind the actual cash outlays made in support of the contract, including cash outlays for materials inventory and capital expenditures. Guidance to contracting officers should make it clear that the test for unreasonably low or negative levels of contractor investment must focus on the entire period of performance.

Similarly, while CODSIA members believe it would be desirable to permit performance-based payments on competitive procurements, the proposed rule will undoubtedly generate a number of major contractual problems. First, how will the contracting agency ensure that contractors are not forced into performance-based payments as a condition of award? As noted above, performance-based payments should continue to be the preferred method of financing *only* when the contractor agrees to their use. Second, how would a contractor opt for progress payments in lieu of performance-based payments in competitive procurements? At the moment, the solicited financing arrangement seems to require the exclusive use of performance-based payments. Would a request for progress payments instead be considered non-responsive?

Another concern is how performance-based payments will be considered in the evaluation phase of competitive procurements. The proposed rule requires that the contracting officer impute an amount to add to the evaluated price if a contractor proposes performance-based payments. We recommend that this provision be eliminated from the rule. A contractor who agrees to performance-based payments should *not* be penalized in a competitive evaluation. If the proposed rule is implemented, the Government has made the need for contract financing a handicap in the evaluation and award process, which is a departure from a long-standing Government policy. We believe, as a matter of policy, that the emphasis on performance and additional risks to the contractor inherent in the use of performance-based payments is adequate consideration for the Government to evaluate the proposal without adding an imputed amount to the evaluated price. Requiring contracting officers to impute an amount to add to the evaluated price will discourage competitors from proposing performance-based payments.

Other Progress Payments

We note that the FAR Council proposes to remove the authority granted DoD for flexible progress payments. We believe that as a regulatory matter such coverage in the FAR is not

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essential to the authority granted DoD to use flexible progress payments. As the FAR Council will no doubt recall, a flexible progress payment method had been recommended by Congress in 1980 in an effort to bolster the deteriorating defense industrial base.⁵ We wish to take this opportunity to again express our view that DoD should not eliminate this important contract financing tool. (See our previous letter on this topic.⁴)

Similarly, the proposed rule would remove the authority granted DoD for adoption of a higher progress payment rate for Foreign Military Sales (FMS) contracts. CODSIA members continue to believe that a higher progress payment rate on FMS contracts is justified. Member companies observe that payments on these contracts are slower than on contracts using appropriated funds because of an extra step in the funds approval and payment process. We ask that the progress payment rate for FMS contracts be increased to compensate industry for the slower payments.

In any event, CODSIA members do not believe the recommended removal of the progress payment provisions at FAR 32.501-1 would preclude DoD from implementing them in the DFARS. They are clearly necessary to meet the specific needs of DoD (see FAR 1.302).

In closing, CODSIA members appreciate the opportunity to comment on the proposed rule and look forward to working with the DAR/CAAC Councils in the consideration of our suggested revisions. If you have any questions or need additional information, please call Mr. Dave Koonce at (301) 897-6657.

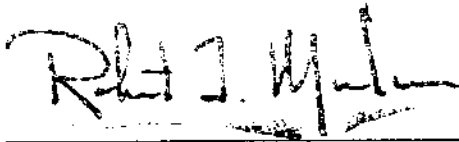
Sincerely,

SEE ATTACHED CODSIA SIGNATORIES

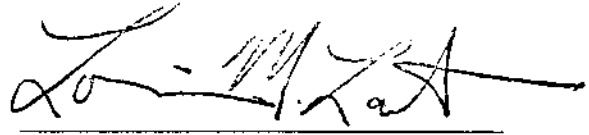
cc: Administrator, Office of Federal Procurement Policy
Director of Defense Procurement

⁵ House of Representatives, Committee on Armed Services, Defense Industrial Base Panel, "The Ailing Defense Industrial Base: Unready for Crisis," December 31, 1980.

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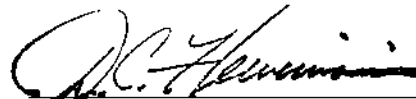
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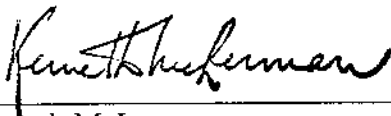
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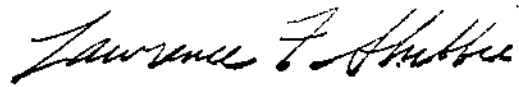
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