

COUNCIL OF DEFENSE AND SPACE INDUSTRY ASSOCIATIONS

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July 6, 1999
CODSIA Case No. 8-99

Ms. Sandra G. Haberlin
Defense Acquisition Regulations Council
PDUSD(A&T)DP(DAR)
IMD 3D139
3062 Defense Pentagon
Washington, DC 20301-3062

Reference: Weighted Guidelines and Performance-Based Payments (DFARS Case 99-D001)

Dear Ms. Haberlin:

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 May 4, 1999 (Vol. 64, No. 85). 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 DAR Council proposed to establish separate profit values under the Weighted Guidelines Method for contracts using performance-based payments. Specifically, new profit values would be established for contract type risk at DFARS 215.404-71-3(c) as shown in Table 1. Normal profit values would be 4% on FFP contracts and 2% on FPI contracts (i.e., midpoint of designated range). The working capital adjustment would not be applied.

Table 1
Contract Type Risk and Working Capital Adjustment

	Contract Type Risk	Working Capital Adjustment
FFP with no financing	4% to 6%	None
<i>FFP with performance-based payments</i>	<i>2.5% to 5.5%</i>	<i>None</i>
FFP with progress payments	2% to 4%	0% to 4%

FPI with no financing	2% to 4%	None
<i>FPI with performance-based payments</i>	<i>.5% to 3.5%</i>	<i>None</i>
FPI with progress payments	0% to 2%	0% to 4%

CODSIA members support the proposed rule and urge the DAR Council to issue a final rule as quickly as possible. As the DAR Council knows, the working capital adjustment was calibrated to DoD's progress payment policies based on the results of the Defense Finance and Investment Review (DFAIR) which was conducted in 1985. Performance-based payments did not become a contract financing tool until 1995. There are a number of key differences between progress payments and performance-based payments which make the current method of assessing contract type risk unworkable. Some of these differences are shown in Table 2 below.

Table 2
Progress Payment Policies vs Performance-Based Payment Policies

	Progress Payments	Performance-Based Payments
Rate of payment	80% of cost	90% of price*
Portion of contract covered	100%	Variable
Initiation of payment	1 st month	1 st event
Frequently of payment	Monthly	Monthly or less
Speed of payment	7 th day	14 th day target/30 th day norm
Probability of success	Not considered	Variable
Government consideration	Implicit in price	Explicit evaluation

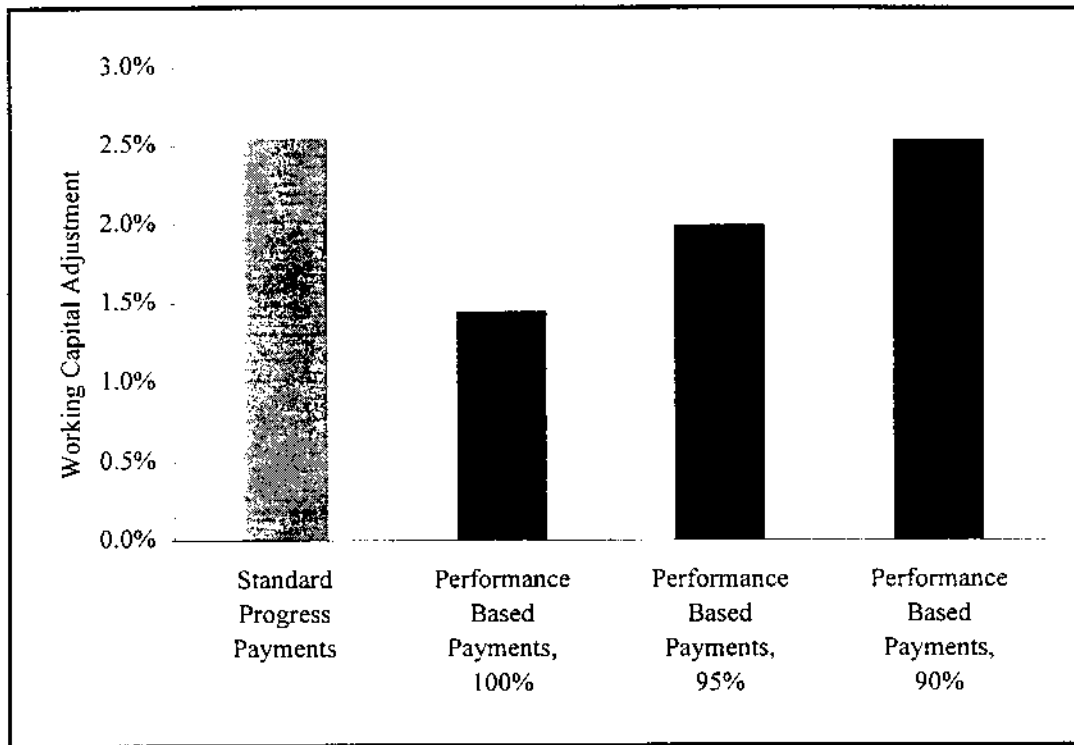
* Maximum allowed

The proposed rule would fill the void in guidance for establishing profit values on contracts using performance-based payments. Presently, we have observed cases where contracting officers have equated performance-based payments to progress payments at the rate of 100% which basically yields only 3% for contract type risk and working capital adjustment combined on FFP type contracts. This implies that the contractor has no working capital investment in the work-in-process inventory which, of course, is wrong. Even if the entire contract were covered by performance-based payments at 90% of price, there still can be a substantial investment in working capital.

Notwithstanding the need to issue a final rule as quickly as possible, we believe that the guidance needs to be better developed. The proposed rule basically limits the contracting officer's risk considerations on performance-based payments to rate of payment, frequency of payment, and risk of payment. The rule should be made clear that the contracting officer should consider all variables which affect working capital costs. For example, other variables might include initiation of payment, speed of payment, portion of contract covered by payment, etc. In addition, we are concerned about the apparent lack of coordination between the FAR's requirement at 32.1004 to evaluate financing costs to the Government when using performance-based payments and the DFARS's Weighted Guidelines Method. This lack of coordination creates the potential for excessive consideration demands being placed on the contractor.

While we agree that separate profit values for contract type risk is necessary, we believe the proposed ranges will be insufficient to cover working capital costs under performance-based payment arrangements. For example, using DFAIR's model, working capital costs on an FFP contract with 80% progress payments would be 2.5% of total contract costs (see chart below). Using the same model on an FFP contract with 90% performance-based payments and 100% probability of success, working capital costs would be 1.4% of total contract costs. However, under the same conditions and 90% probability of success, working capital costs increase to 2.5%, the same as 80% progress payments. Under the proposed rule, it is likely that the contract with 80% progress payments would be assigned a greater profit value than the 90% performance-based payments and 90% probability of success.

Impact of Success on Performance-Based Payments



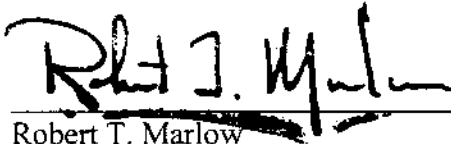
The proposed range of profit values are far too narrow to fully address working capital costs under performance-based payment arrangements. The maximum profit value for contract type risk on an FFP with progress payments is 8% with working capital adjustment. The proposed maximum profit value on an FFP contract with performance-based payments is only 5.5%, even though as previously shown working capital costs could be the same. We urge the DAR Council to establish a broader designated range (2% to 8%) and a higher normal value (5%) on FFP contracts with performance based payments and commensurate values on FPI contracts. Otherwise, the Weighted Guidelines Method may become an obstacle to DoD's objectives for making greater use of performance-based payment arrangements.

In closing, CODSIA members appreciate the opportunity to comment on the proposed rule and look forward to working with the DAR Council. If you have any questions or need additional information, please call Ruth Franklin, NDIA Director for Procurement, at (703) 247-2598.

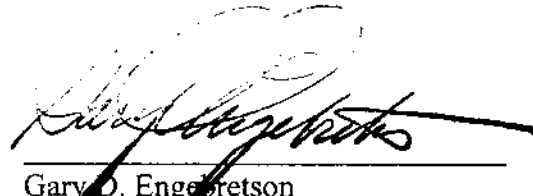
Sincerely,

SEE ATTACHED CODSIA SIGNATORIES

Ms. Haberlin
July 6, 1999
Page 5



Robert T. Marlow
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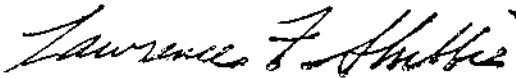
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cc: Director of Defense Procurement