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STATEMENT OF

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BEFORE THE

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

"AWARD FEE CONTRACTING"

AUGUST 3, 2009

Chairman Carper, Senator McCain, members of the Subcommittee, thank you for the invitation to testify before the subcommittee today on the issue of the effective use of award fee contracts to incentivize excellent contractor performance.

Introduction

The Professional Services Council (PSC) is the leading national trade association of the government professional and technical services industry. PSC's more than 330 member companies represent small, medium and large businesses that provide federal agencies with services of all kinds, including information technology, engineering, logistics, facilities management, operations and maintenance, consulting, international development, scientific, social and environmental services, and more. Together, the association's members employ hundreds of thousands of Americans in the fifty states.

Mr. Chairman, performance matters. Both government agencies and contractors need to understand the contractual requirements imposed and the compliance obligations being undertaken. It is also appropriate to look at the business relationship between the government and the contractor— including the contract type—to understand the performance obligations.

Award Fee Contracts

An award fee contract is a contract that provides for a fee consisting of a base amount (which may be zero) fixed at inception of the contract and an award amount, based on a judgmental evaluation by the government. A contractor may earn an award fee, in whole or in part, by meeting or exceeding criteria stated in the award fee plan that details the implementing procedures and the methodology to be used to evaluate a contractor's performance during pre-determined evaluation periods. Contracts may be either fixed-price with award fee[1] or, more commonly, cost-reimbursement with award fee.[2]

Award fee contracts are only one type of contract used by federal agencies, and these are not used commonly across the government. As OMB noted, only about one quarter of all fiscal year 2008 contract awards were cost-type contracts, and those had a value of approximately $136 billion.[3] The GAO report that is one basis for today's hearing[4] confirmed that the five agencies that used award fee contracts accounted for over 95 percent of the dollars spent on award fee contracts in fiscal year 2008. Ninety percent of federal dollars spent through award fee contracts were awarded by DoD, Energy and NASA.

The selection of the contract type for any procurement is a government decision, which should be made based on an assessment of the nature of the work to be accomplished and the objectives to be achieved. For example, the Federal Acquisition Regulation (FAR)

[1] FAR 16.404(a)
[2] FAR 16.405-2
[3] OMB 3/18/09 Report to Congress, as required by Section 864 of the FY 2009 National Defense Authorization Act, available at: http://www.whitehouse.gov/omb/assets/procurement/cost_contracting_report_031809.pdf.
[4] "Federal Contracting: Guidance on Award Fees Has Led to Better Practices but Is Not Consistently Applied," (GAO 09-630; May 29, 2009), available at: http://www.gao.gov/new.items/d09630.pdf.

provides that an award fee should be used when the work to be performed is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, technical performance, or schedule.[5]

There are many fallacies about award fee contracts. One common myth is that the award fee is equal to "more contractor profit;" this myth ignores the very incentive nature of award fee contracting. A second is that the award fee is paid even for a contractor's "satisfactory" performance of a contract. This myth ignores the key elements of the government-established award fee plan that structures the outcomes to be achieved and the methodology for evaluating the contractor's performance and often fails to recognize that, prior to recent legislative and regulatory changes, "satisfactory" performance often meant that the contractor "fully performed" according to the award fee criteria— not merely complied with the basic contract requirements.

But there are also many truths about award fee plans and award fee contracting. First, these are difficult contracts for agencies to write and for contractors to compete for. The challenge for the procuring agency is to describe the minimum performance of the contract and then to describe the appropriate "motivational" objectives— whether they be quality, timeliness, technical ingenuity, cost management or others. Second, the metrics selected as the evaluation criteria in the award fee plan must be directly related to the objectives to be accomplished and must accurately measure the intended performance objectives. Finally, there must be government personnel knowledgeable about the motivational objectives to be achieved and the metrics selected and used; a contracting officer doesn't normally have these skills and this is another example of the skills shortage that is often evident, with real implications, in the acquisition workforce.

There is another important factor to put on the table when addressing the current uses of award fees. As I noted earlier, and as GAO has pointed out in its report, the FAR provides that an award fee contract should have two components – a base fee fixed at inception and an "award" amount that the contractor may earn.[6] According to the federal budget scoring rules, when an agency provides for a "base fee," the agency must "score" that amount as an obligation at the time the contract is awarded. Thus, over the past several budget cycles, as agencies tried (or were directed) to minimize their contractual spending, they significantly shifted funds away from traditional "base fee" amounts – essentially adopting a zero base fee approach – and allocated more funds into the "award" fee portion of the contract that would be "obligated" only after the fee determining official made the award fee decision. Simply put, budget rules drove contracting practices and the recent use of award fees masks the significant and intentional contractual and performance differences between "base" and "award" fees and between "satisfactory contract compliance" and stretch objectives.

Finally, once the award fee plan is established, it must be adhered to by all parties. The government has a responsibility to fairly evaluate the contractor's performance against the metrics in the award fee plan, make a fair and justifiable determination of the

[5] FAR 16. 405-2(b).
[6] FAR 16.405-2(a)

contractor's accomplishments under that plan, and pay accordingly! Too often we hear about agencies delaying their review of the contractor's award fee submissions or failing to make any award fee determination, and failing to make payment according to the award fee schedule. By breaking faith with the contractor over the award fee plan, the agencies put contractors – particularly smaller and mid-tier firms – at greater financial risk.

GAO's May 2009 Report

The GAO's May report provides useful background information on 1) cost-plus award fee contracts, 2) the legislation Congress enacted in fiscal years 2007 and 2009 National Defense Authorization Act, 3) the guidance issued in December 2007 by the Office of Federal Procurement Policy, and 4) the implementation by the five key federal agencies that award the preponderance of award-fee contracts. Clearly progress has been made, and further action can be taken by the agencies in award-fee contracting. Where GAO has identified gaps in the planning, information collection and contracting practices of the five agencies, we support their recommendations. But this report doesn't call for new legislation or regulations and we concur that none are necessary.

However, we are concerned about some of implications in the GAO report that suggests that some award fee plans are improperly "rewarding" contractors or that roll-over fees are inappropriate. We strongly recommend to agencies that ask for our views on these issues that they must be clear in differentiating full contract performance from incentivized behaviors and that their award fee plan, along with its implementation, must be clearly defined, adhered to, and fairly executed. We strongly recommend to our member companies who ask about these plans to first read the solicitation and the proposed award fee plan to make sure that there are clear differences between contract performance and incentivized behaviors, that the award fee plan and the metrics to be used are clear, and that the agency has a track record of following their plans.

Additional FAR Regulations

GAO and other witnesses have indicated that further FAR regulations are likely. In fact, we understand that an interim rule will be published shortly making a further change to FAR 16.4 that would incorporate the government-wide provisions enacted in Section 867 of the fiscal year 2009 National Defense Authorization Act. We will watch for that rule and will comment on it, if appropriate.

House-Passed FY 10 National Defense Authorization Act (HR 2647) Section 824

I wanted to call to the committee's attention Section 824 of the House-passed National Defense Authorization Act titled "Requirement for Secretary of Defense to Deny Award and Incentive Fees to Companies Found to Jeopardize Health or Safety of Government Personnel."

Section 824 would require the Secretary of Defense to prohibit the payment of award and incentive fees to any defense prime contractor or subcontractor who is determined through a criminal conviction, or a civil or administrative proceeding resulting in a finding of fault and the payment of a fine, penalty, reimbursement, restitution or

damages, to be responsible for causing the death or serious bodily injury of any civilian or military personnel of the government through gross negligence or reckless disregard for safety. A prime contractor is also accountable if it awards a subcontract determined to be responsible for such injury or death but only to the extent that the prime contractor has been determined to also be liable for the actions of the subcontractor. No later than 90 days after any such determination is made, the secretary shall determine whether the contractor or subcontractor should be debarred from contracting with the Department of Defense; however, the secretary may waive the effect of any of the determinations made on a case-by-case basis if the prohibition would jeopardize national security and the secretary notifies the congressional defense committees.

The prohibition would apply to contracts awarded after 180 days after enactment. Within 180 days after enactment, the secretary shall issue regulations implementing the prohibition and shall establish in such regulations: (1) that the prohibition applies only to award and incentive fees under a contract; (2) that the prohibition shall include all award and incentive fees associated with performance in the year in which the injury or death resulting in the disposition occurred; and (3) mechanisms for the recovery by or repayment to the government of award and incentive fees paid prior to the determination.

The core of this language – including the determination based on a criminal or civil conviction or an administrative proceeding – is drawn from 2008 legislation that would create an internal government-access only database of contractor conduct that would be used by government contracting officers to determine whether a prospective contractor is a "responsible" contractor and thus eligible for being awarded future contracts. In this provision, however, such standards are used to automatically and arbitrarily deny a contractor access to any award or incentive fees that may have already been earned based on such actions or determination that are not tied to any specific contract—including those already performed and where fees have already been properly awarded. Simply drawing from language already in use in one area does not justify its use in a completely different context; the two provisions are very different and the use of the information creates significantly different results.

Furthermore, in the context of contract performance, we are concerned that the broad coverage of administrative proceedings could open the door to a wide range of administrative actions – such as corrective action reports – that are designed to provide simple and prompt notices to contractors of potential performance deficiencies that are routinely and promptly accepted by contractors that could now be turned into significant legal challenges because of the significant potential consequences arising from such corrective actions.

We recognize it is always tragic when military, civilian government and contractor employees have been seriously injured in warzones. DoD already has significant flexibility under the existing acquisition regulations to address contractor culpability when evaluating award and incentive fees for a contractor's performance. We strongly oppose this provision.

Conclusion

Cost plus award fee contracting is an appropriate contract type and agencies should have the flexibility to select this contract type – as with every other contract type – to best meet the buying activities' requirements and to select the best acquisition method available. PSC supported the Office of Federal Procurement Policy's December 2007 guidance to the agencies on appropriate award fee practices—but agencies also must have the flexibility to implement that guidance in a manner that takes into account their specific requirements and market needs. Congress has already enacted provisions further directing federal agencies on how to structure award fee plans and what fees to pay.

The five agencies identified in the GAO report should ensure that the OFPP December 2007 guidance is implemented in each agency in a manner appropriate to the nature of its contracts. Except for the regulations already in process to implement existing law, we should give these agencies an opportunity to take administrative action, implement their own guidance in new contracts and give the acquisition process a chance to work.

Thank you again for the invitation to address this important matter. I look forward to any questions the subcommittee may have.