2015

Emerging Policy and Practice Issues (2015)

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Recommended Citation

West Government Contracts Year in Review Conference Covering 2014 Conference Briefs, Thomson Reuters, 2015

SESSION 9

EMERGING POLICY AND PRACTICE ISSUES

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I. THE POST-MILLENIUM PROCUREMENT SPENDING REDUCTION CONTINUES: IS THERE A PLATEAU ON THE HORIZON?

A. The New Economic Reality: Not So New Anymore. Procurement spending decreased significantly again last year. Although this is no surprise, some will take comfort that the rate of decrease appears to have slowed after the prior year's dramatic sequester-induced plunge. Moreover, the downward trend feels increasingly familiar, with this being the sixth year of the federal procurement spending decline.

B. Finding the Bottom (Below $500 Billion)? Regular attendees of this conference are familiar with this chapter's coverage of the post-millennium federal procurement spending trend. The post-millennial binge (before the contraction) was significant not only for its longevity but for its size. Keep in mind that, in Fiscal Year 2001, federal procurement spending rose to just over $223 billion. The following years, in 2002 and 2003, we witnessed 18 and 20 percent spending increases. After steady increases in the middle of the decade, we reached an unprecedented plateau where federal procurement spending stabilized at approximately $540 billion from Fiscal Years 2008 through 2011. We now know that, *in 2009, we experienced the first decrease* in federal procurement spending for well over a decade (but it took a number of years for the data to catch up). Then, in 2013, it appears that we finally experienced the first dramatic decline in spending and a plunge below the (oh-so-dramatic) $500 billion threshold that the government exceeded from 2008 through 2012. Now, the search for the bottom – whether a plateau or reversal – continues. Frankly, nothing suggests that the government will again exceed the $500 billion threshold again anytime soon.

Using adjusted figures (yes, between the Federal Procurement Data System (FPDS) and USASpending.gov, history is consistently being re-written), it appears that the annual increases in federal procurement were most dramatic from 2001 through 2008, cumulatively averaging more than three times the rate of inflation. The experts correctly predicted that the growth rate eventually would taper. In 2009, the rate slowed and, apparently, growth finally stalled. Yet, as discussed in past years, the dire warnings that the current spending binge was a blip – and that procurement spending would promptly retract – unfolded far more slowly than anyone expected. Indeed, the recently adjusted numbers paint a picture of extraordinary spending consistency – from 2008 through 2011 – that appears as quirky as it is accidental.

The chart below summarizes this procurement spending cycle. The $540 billion plateau represented the high end of a robust and sustained growth curve. Time will tell how far the reductions will go and whether they can be sustained. But, if we broaden our thinking or redefine the pie we are describing, the bad news can be tempered. Accordingly, this year I've combined federal procurement and grant spending into a single chart (rather than viewing the two pies separately before combining them).

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Federal Procurement and Grant Spending 2001-2014*		
Fiscal Year	Procurement Spending (in Billions of $)	Grant Spending (in Billions of $)
2014	$443.3*	**$589.1***
2013	$462.4	**$524.3**
2012	$518.4	**$539.5**
2011	$539.6	**$566.9**
2010	$540.3	**$614.3**
2009	$540.5	**$665.0**
2008	**$541.2**	$419.7
2007	**$469.3**	$430.2
2006	$430.5	**$490.0**
2005	$391.2	**$441.7**
2004	$346.1	**$450.1**
2003	$318.0	**$493.7**
2002	$264.1	**$406.3**
2001	$223.0	**$330.8**
*FY 2014 figures reflect an estimate based upon preliminary reporting.		
The total procurement spending amounts reported above, for every year, 2001-2013, changed by at least $100 million compared to last year's USASpending reports.		

See www.USASpending.gov.

C. Data Quality. Ongoing analysis continues to cast doubt on these figures, but they still represent the most useful data set accessible in the public domain. *See Agencies Underreport Contract Award Data Online, GAO Says*, 56 GC ¶ 263 (GAO reports on "inconsistencies between the data on USASpending.gov and agency records....GAO estimates that only between two and seven percent of the awards contained information that was fully consistent with agencies' records for data elements examined."); GAO-14-476, *Data Transparency: Oversight Needed to Address Underreporting and Inconsistencies on Federal Award Website*, available at gao.gov/assets/670/664536.pdf. Cynics might suggest that poor data quality is the norm in federal procurement, but that would be an unfair overstatement. *See Agency Reporting Of Contractor Past Performance Could Be Improved, GAO Says,* 56 GC ¶ 270 ("although agencies generally have improved their level of compliance with past performance reporting requirements, the rate of compliance varies widely by agency and most have not met OFPP targets. GAO found that the compliance rate ranged from 13 to 83 percent as of April 2014."); GAO-14-707, *Contractor Performance: Actions Taken to Improve Reporting of Past Performance Information*, available at www.gao.gov/assets/670/665238.pdf.

D. The Chasm Between Contracts and Grants Begins to Shrink. Plenty of contracting experts assert that, fundamentally, not much distinguishes a government contract from a federal grant. Many contractors also compete for and receive grants. Despite all of the attention focused upon (and burdensome oversight associated with) government contracting, grant spending continues to outpace procurement spending. The oversight and regulatory community appears to have woken up to this reality and is slowly shifting its focus from procurement to grants. Indeed, late in 2013, the government announced a significant revamping of the regulatory regime surrounding grants. *See Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, 78 Fed. Reg. 78590 (Dec. 26, 2013) (amending and replacing 2 C.F.R. Chapter I, and Chapter II, Parts 200, 215, 220, 225, and 230), *available at http://www.gpo.gov/fdsys/pkg/FR-2013-12-26/pdf/2013-30465.pdf*.

Consistent with the trend I've previously reported, grant spending exceeded procurement spending last year, as it has for *twelve of the last fourteen years*. Moreover, while grant spending fell after peaking in FY2010, grants – unlike contracts – never fell below the $500 billion threshold. Moreover, the grant decline only lasted four years before climbing again, and the FY2014 increase was significant, vaulting grant spending to its third highest level ever.

E. Sound and Fury Proves Preferable to Sequestration. While once again the government spent less money last year (and most likely will continue to do so for the foreseeable future), the dramatic disruption of sequestration was not repeated. That should not suggest that everything was rosy in terms of the kind of stable funding that facilitates efficient, long-term investment decisions. *See CSIS Finds DOD Contract Spending Growth Slows Under Sequestration,* 56 GC ¶ 348 ("data show that a disproportionate share of the budget reductions under both the [Budget Control Act of 2011] and sequestration has been borne by contracts and by the defense industrial base."), CSIS, *supra*; *DOD Needs Better Cost-Savings Estimates For Future Furloughs,* 56 GC ¶ 207 ("DOD officials told GAO that the furlough caused a decline in morale and mission delays. GAO responded that attributing these impacts directly to the furlough is difficult because the civilian hiring and pay freezes also may have contributed to morale issues."); GAO-14-529, *Sequestration: Comprehensive and Updated Cost Savings Would Better Inform DOD Decision Makers If Future Civilian Furloughs Occur*, available at www.gao.gov/assets/670/664142.pdf. *See also*, Sarah E. Kahn & C. Kevin Kobbe, *Defense Industry M&A In The Wake Of The BCA Passage And Sequestration--Avoiding Pitfalls In A Distressed Deal Context,* 56 GC ¶ 147 ("current environment suggests that a buyer's market is generally shaping up in defense industry M&A (excepting certain businesses such as those in the UAV space)"); *Funding Instability Undermines DHS Acquisition Management,* 56 GC ¶ 158 ("short-term budget decisions continue to supersede a more strategic approach to prioritizing the department's acquisitions").

Unfortunately, nothing suggests that, after the mid-term elections and the resulting increase in Republican legislative control, that Congress and the President see eye-to-eye on budgeting going forward. It is simply too early to tell what next year will bring. Still, at least for now, this bizarre equilibrium – a bipartisan distaste for another shutdown – contributes to

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some amount of short-term budget stability. Of course, there are always scenarios that could generate surges in procurement spending, but they tend to be associated with events (such as terrorism and war, natural disasters, or economic crises) that, at the moment, appear less attractive than belt-tightening.

II. GOVERNMENT-WIDE (OR, NOT JUST DEFENSE) POLICY?

A. New OFPP Administrator for the New Year. The Executive Office has a (relatively) new procurement policy czar, with Administrator Anne Rung now in place at the Office of Federal Procurement Policy (OFPP). Rung brings considerable experience from GSA and the Commerce Department, as well as experience gained at the state level with Pennsylvania's Department of General Services. Late in the year, Rung offered a glimpse of her priorities with the publication of an ambitious, wide-ranging articulation of initiatives and aspirations. *See OFPP Guidance Aims For Federal Contracting Innovations*, 56 GC ¶ 396, discussing OFPP Memorandum, *Transforming the Marketplace: Simplifying Federal Procurement to Improve Performance, Drive Innovation, and Increase Savings* (December 4, 2014).

In the memo, Administrator's Rung discusses, among other things:

- **Buying As One Through Category Management:** "There is a critical need for a new paradigm for purchasing that moves from managing purchases and price individually across thousands of procurement units to managing entire categories of common spend and total cost through category management … [so] that agencies get the same competitive price and quality of performance when they are buying similar commodities under similar circumstances[.]" To the extent that the Strategic Sourcing Leadership Council (SSLC) helps agencies reduce contract duplication, efficiency should be increased. I am less sanguine about the belief that collecting and distributing "prices paid" for anything other than commodities will benefit the government in the long run, and it raises particular concerns with regard to services.

- **Deploying Talent and Tools Across Agencies and Growing Talent Within Agencies to Drive Innovation.** Kudos to Rung for acknowledging that the government "must embrace practices that encourage new and better ways of thinking[.]" That's a given. It would also be refreshing to "instill a culture that rewards creativity." And I'm ecstatic to see the new OFPP administrator focus on "cross-functional training, rotational development and assignments, and effective training and education used by the private sector."

- Detouring from the memorandum, it was a surprisingly quiet year in terms of efforts to invest in the acquisition workforce, which is not good news. None of the long-standing, systemic concerns discussed annually in this chapter were addressed, not is there reason for optimism in the current budgetary environment. See, generally, *CRS Focuses On Workforce, Incentives As Keys To DOD Acquisition Reform*, 56 GC ¶ 196 ("[T]he incentives in the acquisition process, analysts argue, encourage people to make poor decisions"); CRS Report R43566, *Defense Acquisi-*

tion Reform: Background, Analysis, and Issues for Congress, available at www.fas.org/sgp/crs/natsec/R43566.pdf.

• **Building Stronger Vendor Relationships.** This one should be fun to watch, particularly since the government struggles with the concept and often invests significant energy discouraging and deterring the kinds of behavior that create and sustain meaningful relationships between government customers and private industry. It is encouraging to hear the Administrator adopt the aspirations of her predecessor's Myth-Busting campaign with the message: "Early, frequent, and constructive engagement with industry leads to better outcomes."

• As suggested previously however, it seems disingenuous for the White House to suggest a correlation between procurement-policy-related moves and "savings" to the taxpayers. OFPP (and the White House) may be pleased that "contract spending decreased by over $55 billion in Fiscal Year 2013 from the prior year – part of a four-year decrease in the cost of Federal contracting." Yet readers understandably may become confused where the memo suggests that Administration "efforts are paying off[.]" The memo lumps "steps to strengthen Federal acquisition practices to improve efficiency [and] reduce red-tape ... [and] new efforts to pool the Government's buying power through strategic sourcing, and ... other smart buying strategies" together in a sentence with "cut[ting] contracts that are no longer necessary or affordable...." And, yes, indeed, the government spent less on supplies and services in 2013. But, empirically, history will more likely reflect that a shortage of funds (and sequestration) was the dominant factor behind the reduced spending, rather than any combination of strategic procurement reforms.

B. A Note On Transitions: Last year, Joe Jordan was in the process of leaving the Office of Federal Procurement Policy (OFPP) and joining FedBid as President of Public Sector. In retrospect, his timing may have proven suboptimal. *VHA Reverse Auctions Suffer From Poor Documentation, Unreliable Savings, FSS Conflicts,* 56 GC ¶ 319; VA Office of the Inspector General, *Review of the Veterans Health Administration's Use of Reverse Auction Acquisitions* (September 26, 2014), available at www.va.gov/oig/pubs/VAOIG-13-01408-294.pdf; *see also*, VA Office of the Inspector General, *Administrative Investigation Conduct Prejudicial to the Government and Interference of a VA Official for the Financial Benefit of a Contractor Veterans Health Administration Procurement & Logistics Office Washington, DC* (September 26, 2014), available at http://www.va.gov/oig/pubs/VAOIG-13-03065-304.pdf; Christian Davenport, *VA contracting official misused her position to help company, inspector general finds*, WASHINGTON POST (October 5, 2014); Andy Medici, *IG: VA official gamed system to benefit FedBid*, FEDERAL TIMES (September 29, 2014), available at http://archive.federaltimes.com/article/20140929/MGMT04/309290022/IG-VA-official-gamed-system-benefit-FedBid.

C. Another Challenge Ahead: One of the most significant challenges for OFPP is to somehow realign itself with the defense acquisition policy discussion and community. Far too often, OFPP and DoD policy documents and, more broadly, policies, seem uncoordinated and inconsistent. In the long run, this divide must be bridged. (I return to DoD below.)

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D. Executive Order Bonanza. Immediately upon his inauguration, President Obama demonstrated a strong interest in Executive Orders (EO's) and did not hesitate to deploy them in the procurement arena. The administration returned its attention to EO's last year. Only time will tell how active this approach remains for the duration of the President's second term. As discussed elsewhere in these materials, the EO activity included:

- **Prohibiting Federal Contractors from Discriminating Against Employees Based on Sexual Orientation.** EO 13672, Further Amendments to Executive Order 11478, Equal Employment Opportunity in the Federal Government, and Executive Order 11246, Equal Employment Opportunity, *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-07-23/pdf/2014-17522.pdf. *See DOL Issues Final Rule Prohibiting Discrimination Based On Sexual Orientation,* 56 GC ¶ 402 ("prohibits federal contractors and federally assisted construction contractors and subcontractors that do over $10,000 in Government business in one year from discriminating in employment decisions on the basis of race, color, religion, sex, sexual orientation, gender identity or national origin"); *President Signs Order Barring LGBT Discrimination By Federal Contractors,* 56 GC ¶ 246 ("expands EO 11246, signed by President Johnson, and EO 11478, signed by President Nixon, to prohibit federal contractors from discriminating on the basis of sexual orientation or gender identity"); 79 Fed. Reg. 20749 (July 21, 2014) ("uniform policy for the Federal Government to prohibit discrimination … based on sexual orientation and gender identity"); *Lawmakers Call For Executive Order Banning LGBT Discrimination,* 56 GC ¶ 102.
- **Raising the Minimum Wage for Federal Contractors.** *DOL Issues Final Rule On Contractor Minimum Wage,* 56 GC ¶ 329 ("On October 1, the Department of Labor issued a final rule implementing Executive Order 13658 and raising the minimum wage for workers on federal construction and service contracts to $10.10 per hour. See 79 Fed. Reg. 60633 (Oct. 7, 2014). In future years, the minimum wage will be indexed to inflation."); *PSC Calls For Clarifying Proposed Contractor Minimum Wage Rule*, 56 GC ¶ 258; 56 GC ¶ 210(a); *President Sets Contractor Employee Minimum Wage*, 56 GC ¶ 57 (including a potentially mixed message that: "Raising the pay of low-wage workers increases their morale and the productivity and quality of their work, lowers turnover and its accompanying costs, and reduces supervisory costs" while the order is intended "to increase efficiency and cost savings in the work performed by parties who contract with the Federal Government"); 56 GC ¶ 36(d).
- **Prohibiting Contractor Retaliation for Employee Disclosure of Compensation.** EO 13665, 79 Fed. Reg. 20749 (April 11, 2014), memo available at www.whitehouse.gov/the-press-office/2014/04/08/presidential-memorandum-advancing-pay-equality-through-compensation-data; http://www.whitehouse.

gov/the-press-office/2014/04/08/executive-order-non-retaliation-disclosure-compensation-information; *Executive Order Protects Contractor Employees' Right To Discuss Pay Information,* 56 GC ¶ 116 (requiring contractors to allow disclosure of compensation levels without retaliation to battle sex discrimination, and directing the Department of Labor to propose a rule to require reporting of summary compensation data broken down by sex and race).

- **Requiring Consideration of Labor Law Compliance as an Aspect of the Contracting Officer's Responsibility Determination.** EO 13673, Fair Pay and Safe Workplaces, http://www.gpo.gov/fdsys/pkg/FR-2014-08-05/pdf/2014-18561.pdf; 79 Fed. Reg. 45309 (Aug. 5, 2014); *Executive Order Targets Contractor Compliance With Labor Laws*, 56 GC ¶ 266 (President Obama "issued an executive order, requiring prospective contractors to disclose violations of labor laws in the last three years. Contracting officers will consider the disclosures in responsibility determinations."); 56 GC ¶ 373(e) ("EO 13673 requires prospective Government contractors to disclose 'whether there has been any administrative merits determination, arbitral award or decision, or civil judgment ... against the offeror within the preceding 3-year period for violations of' labor laws.").

E. The Next Round of Congressional Acquisition Reform? Congress seems significantly interested in reforming federal acquisition, but it is unclear what direction, if any, Congress will take. *Congress Passes 2015 Defense Authorization Act,* 56 GC ¶ 400; *House Democrats Propose Defense Acquisition Reforms,* 56 GC ¶ 340 ("five principles underlying [the New Democrat Coalition (NDC)] proposals are ending sequestration, making the Government a better customer to industry, empowering and growing the DOD acquisition workforce, improving management and accountability, and changing the culture for long-term success"); *DOD Acquisition Reform Continues, Has Room To Grow, Witnesses Tell House Committee,* 56 GC ¶ 226; *House Committee Considers Future Of DOD Acquisition Reform,* 56 GC ¶ 216; Mike Schaengold & Jack Deschauer, *The Impact Of The National Defense Authorization Act For Fiscal Year 2014 On Federal Procurement,* 56 GC ¶ 50.

The most intriguing initiative, however, derived from the Senate Permanent Subcommittee on Investigations (PSI), which issued its bipartisan report, *Defense Acquisition Reform: Where Do We Go From Here? A Compendium of Views by Leading Experts* (October 2, 2014). The document collects more than thirty short essays from knowledgeable defense acquisition professionals with a broad range of backgrounds and perspectives. The Subcommittee suggested that certain common themes emerged and noted that (with emphasis added):

- *Nearly half* of the experts feel that cultural change is required while over two-thirds believe improving incentives for the acquisition workforce is necessary for reform.
- *Two-thirds* of the contributors feel that training and recruiting of the acquisition workforce must be improved.

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- *Nearly half* believe that DOD needs to attain realistic requirements at the start of a major acquisition program that includes budget-informed decisions.
- *More than half* of the submissions noted the need for strong accountability and leadership throughout the life-cycle of a weapon system – with several experts stating the need to further integrate the Service Chiefs into the acquisition process.

After the essays, the document includes an interesting appendix, which correlates the various authors and topics in a series of matrices. The initial matrix identifies all of the authors (on the y-axis) and indicates the areas they emphasized on an alphabetical list of fourteen potential topics (on the x-axis). Consistent with the four initial findings, above, response rates across the fourteen topics (indicated in italics, below) varied from:

- *Additional workforce training needed* and *Attract and retain quality workforce* - both garnering over 70 percent; to
- *Refine Goldwater-Nichols* – which came in at under twenty-three percent.

For the subsequent matrices, essay authors were organized by topics or interests, including:

- **Acquisition Policy** – of these, one hundred percent emphasized *Additional workforce training needed* and *Attract and retain quality workforce,* and fewer than fifteen percent emphasized *Refine Goldwater-Nichols* (and a number of other issues);
- **Budgeting and Resource Allocation** – This was one of only two subgroups in which more than fifty percent emphasized improving the budget process. No one in this group, however, emphasized *Prototyping/concurrency risk,* and only one emphasized *Testing/"Fly Before You Buy."*
- **Culture and Accountability** – a quick review of the participants suggest that to see a meaningful trend, the report drafters should have separated "culture" and "accountability."
- **Procurement Policy** – I find it surprising that experts and analysts can confidently distinguish between acquisition policy and procurement policy! This group, more than any other, emphasized *Encourag[ing] Innovation*.
- **Requirements Process** - Only twenty percent of this group emphasized *Attain realistic cost estimates early in the process*.

F. Protests On the Rise, Again? The number of bid protest in FY2014 was up five percent from FY2013. Readers may recall that the numbers dropped, slightly, the preceding year, when compared to FY2012. The 2014 numbers seem to suggest that the 2013 reduction was an outlier in the general trend rather than a signal that bid protests are on the decline. *GAO Bid Protest Annual Report to Congress for Fiscal Year 2014,* GAO-15-256SP (indicating that the number of new protests rose to 2,561 in FY2014, up five percent from FY 2013, and exceeding the most recent high of 2,475 from FY 2012), *available at http://www.gao.gov/products/GAO-15-256SP*. Granted, the most unique and memorable aspect of this year's report was GAO's detailing the mere thirty-nine cases which it was unable to resolve within the standard 100 days of when the protest was filed. Sequestration and shut-down delays ranged from two to sixteen days, which, objectively, represents far less disruption than many other government instrumentalities experienced.

Readers interested in these issues should also follow the recent analysis of empirical data to understand the GAO bid protest regime. See, e.g., *CRS Surveys GAO Bid Protest Procedures And CICA Stays Of Performance,* 56 GC ¶ 338, CRS No. R40228, *GAO Bid Protests: An Overview of Time Frames and Procedures*, available at fas.org/sgp/crs/misc/R40228.pdf; Jerald S. Howe, Jr., *Feature Comment: Agency Corrective Action Remains The Dominant Theme – An Analysis Of GAO's Bid Protest Statistics,* 56 GC ¶ 385 ("In examining the statistics for FY 2013, the biggest takeaway had to be the high (both relatively and absolutely) incidence of agency corrective action, and that is the headline again this year."); Daniel I. Gordon, *Feature Comment: Avoiding Bid Protests: Some Advice To Agency Counsel*, 56 GC ¶ 244 (noting, among other things, that "more than 99.2 percent of federal procurements, large and small, move forward without ever being protested"); Jerald S. Howe, Jr., *Feature Comment: The Most Prevalent Reason Why GAO Sustained Bid Protests In FY 2013,* 56 GC ¶ 225 (The "most prevalent reason that [GAO] sustained bid protests in fiscal year 2013 was an agency's flawed evaluation of a technical proposal or an otherwise flawed technical evaluation [, which]... was the basis for a sustained decision in at least half of the sustained decisions ... [and] protests (counted by B-number) sustained by those decisions."]; Daniel I. Gordon, *Feature Comment: Dissecting GAO's Bid Protest 'Effectiveness Rate',* 56 GC ¶ 25 ("in undertaking corrective action, contracting agencies frequently take actions that give the protesters fair consideration for award of the contested contract or order. Voluntary corrective action by agencies thus often translates into prompt resolution of complaints about the way procurements were handled, and, in what some may see as a surprisingly high percentage of the cases, leads to the protesters obtaining the contract or order."); *GAO Bid Protest Filings Decrease Slightly in FY 2013,* 56 GC ¶ 10 ("case filings decreased slightly over FY 2012, which set a 10-year high").

G. Another Complex Year In Small Business. The banner headline in 2014 for the small business community was the unusual achievement of the Congressionally-mandated twenty-three percent goal for small business participation. *Government Meets Small Business Goal For First Time In Eight Years,* 56 GC ¶ 262 (Conversely, "[t]he Government fell short of its small business subcontracting goal of 36 percent; it awarded 34.0 percent of FY 2013 contracting dollars to small business subcontractors, up from 33.6 percent in FY 2012. The Government missed its three- and five-percent goals for Historically Underutilized Business Zone firms and women-owned small businesses; respectively, it awarded 1.76 and 4.32 percent to HUBZone firms and WOSBs. The Government met its three- and five-percent goals for service-disabled veteran-owned small businesses and small disadvantaged businesses; respectively, it awarded 3.38 and 8.61 percent to SDVOSBs and SDBs.")

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• Small business advocates and critics will find many issues to consider. *Agencies Overstate Small Business Contract Dollars Awarded, IG Finds,* 56 GC ¶ 320 ("FPDS-NG controls do not prevent contracting officers from incorrectly designating 8(a) and HUBZone contract awards to ineligible firms"); SBA OIG 14-48, *Agencies Are Overstating Small Disadvantaged Business and HUBZone Goaling Credit by Including Contracts Performed by Ineligible Firms*, available at *www.sba.gov/sites/default/files/oig/Agencies_Are_Overstating_SDB_and HUBZone_Goaling_Credit.pdf*; *SBA Faces Challenges In Small Business Contracting, 8(a) Program Graduation, Acquisition Management*, 56 GC ¶ 345; SBA OIG report available at www.sba.gov/sites/default/files/oig/SBA OIG Report 15-01 - FY 2015 Management Challenges_0.pdf; *8(a) Monitoring Compliance Needs Improvement, GAO Says*, 56 GC ¶ 305 ("COs generally did not collect information on the amount of subcontracted work performed under the 8(a) contracts reviewed"); *GAO, 8(a) Subcontracting Limitations: Continued Noncompliance with Monitoring Requirements Signals Need for Regulatory Change*, available at gao.gov/assets/670/665827.pdf; *GAO Urges Agencies To Better Measure Small Business Participation In Strategic Sourcing*, 56 GC ¶ 63 ("[B]ecause strategic sourcing can reduce the number of available contracting opportunities, some members of the small business community are concerned that small businesses may be negatively affected."); GAO-14-126, *Strategic Sourcing: Selected Agencies Should Develop Performance Measures on Inclusion of Small Businesses and OMB Should Improve Monitoring,* available at www.gao.gov/assets/670/660322.pdf. *House Subcommittee Surveys SBA Outreach To Underserved Communities*, 56 GC ¶ 85 ("there are concerns as to whether underserved communities are receiving adequate access to [SBA] programs"); *CRS Outlines Continuing HUBZone Fraud Risks,* 56 GC ¶ 2 ("It remains to be determined if the SBA's new processes will reduce the incidence of fraud within the program[.]"), www.fas.org/sgp/crs/misc/R41268.pdf.

III. DOD PURCHASING TRENDS: DATA, ANALYSIS, OBSERVATION, AND SPECULATION.

A. A Wealth of Data on DoD Contract Spending. What Can We Learn? While the government dutifully plugs data into its mandatory databases, such as FPDS and USASpending, discussed above, others continue to engage in analysis that generates more sophisticated data to provide better insights into how the federal government's procurement dollars are spent. *CBO Surveys Steady Rise In DOD Acquisition Budget,* 56 GC ¶ 388 (CBO reports that DOD "acquisition appropriations grew by 25 percent between fiscal years 2000 and 2014, while the overall base budget grew by 31 percent during that period...."), available at www.cbo.gov/sites/default/files/cbofiles/attachments/49764-MilitarySpending.pdf.

Long-time readers of this chapter will join me in bemoaning the loss of David Bertau's wisdom and insights at this conference, while applauding the government's good sense in recruiting him as the Assistant Secretary of Defense for Logistics and Materiel Readiness. *See, e.g.*, David J. Berteau, Jesse Ellman, Gregory Sanders & Rhys McCormick, *U.S. Department of Defense Contract Spending and the Supporting Industrial Base, 2000–2013*, A Report of the CSIS National Security Program on Industry and

Resources (October 2014), *available at https://csis.org/files/publication/140929_Ellman_DefenseContractSpending2013_Web.pdf*. After the sequestration smoke cleared, and viewing the thirteen-year trend (2000-2013) in defense spending, CSIS observed, among other things:

- The Army and Navy boom years appear to have run their course. The Army and Navy's slices of the defense procurement pie have returned to the shares seen before the escalation related to the Iraq/Afghanistan efforts. Contract obligations under sequestration dropped by twenty-one percent for the Army and twenty-two percent for the Air Force. During 2012, Army contract obligations declined by fifteen percent.

- In 2000–2002, the Air Force dominated defense acquisition, accounting for 28 percent of DoD's contractual obligations. Since then, the Air Force's share of the pie has declined steadily.

- In 2008, for the first time – *and in every year since*, the Defense Logistics Agency (DLA) and "Other DoD" accounted for a larger share of contractual obligations than the Air Force. ("Other DoD" includes DoD's contracting entities including the Missile Defense Agency (MDA), TRICARE, and U.S. Transportation Command).

- The trends in contract type have ebbed and flowed, but they have not changed dramatically.

- Throughout the thirteen-year period, the balance between cost reimbursement and fixed price contracts remained relatively steady. To the extent there had been a slight recent trend toward fixed price contracts – rising from 60 percent, and peaking at about 68 percent (and away from cost-reimbursement vehicles, which at one point reached a low of twenty-eight percent), that trend was reversed under sequester, with cost-reimbursement contracts representing approximately 30 percent of contract dollars obligated.

- Criticism and focus on time and materials (T&M) contracting took their toll. After accounting for significant sums of contract obligations between 2006 and 2010, T&M contract obligations plummeted during the 2009–2012 budget drawdown and sequestration. (The Army and Air Force were most concentrated sources for this decline, primarily in engineering and technical services and maintenance work.) Currently at a thirteen-year low, T&M's share of overall defense contract obligations was only two percent in 2012, and fell to an almost statistically insignificant one percent in 2013.

- We have been aware, for some time, that services dominate the defense procurement landscape, and that has not dramatically changed. But the mix has not remained entirely stable.

- After peaking in 2008, products declined faster than services (excluding R&D – more on that below). The recent apparent reduction in product purchasing, however, is inflated (or appears overly dramatic) because it follows an anomalous one-year DLA fuel purchasing binge in 2012.

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- Services contracts were not disproportionately cut, except for time and materials contracts (discussed above). Obligations for services basically declined at the same rate of overall spending. (This may appear surprising, given the Obama administration and Congressional efforts to reduce the service contractor FTE (full-time-equivalent) headcount, the government's reliance on service contractors or, as some might suggest "insource.") Indeed CSIS concluded that service contract obligations actually declined more slowly than the DoD average between 2012 and 2013.
  - At the top, however, the picture looked quite different. Under sequestration, the six largest defense contractors experienced a *nineteen percent decline* in services contract obligations.
  - Other than R&D (discussed at length below,) the most pronounced reductions in the services sector were observed with regard to equipment- and facilities-related services and construction.
  - On a related note, see *DOD Contracted Services Inventory Provides Limited Information, GAO Finds,* 56 GC ¶ 386 ("GAO found that military departments 'generally do not have plans to use the inventories for strategic workforce planning, workforce mix and insourcing decisions, or budget and programming decisions.'"), GAO-15-88, *Defense Contractors: Additional Actions Needed to Facilitate the Use of DOD's Inventory of Contracted Services,* available at www.gao.gov/assets/670/667059.pdf.

• The most startling – and, in the long-term, potentially troubling – story relates to **research and development (R&D)**:

- CSIS reported that: "In absolute terms, DoD in 2013 obligated less for R&D contracts than in any year since 2001."
- After R&D contract obligations fell by eleven percent in 2012, R&D spending declined by another twenty-one percent under sequestration. That drop was *fifty percent more severe* than the average decline experienced by DoD in 2013.
- Moreover, Defense R&D contract obligations had been declining steadily since 2009, yet, under sequestration, the decline appeared both quantitatively and qualitatively different. CSIS quotes Frank Kendall's September 5, 2013 Federal News Radio prediction that: "If we're talking about an overall budget cut of 10 percent across the department, you can about double that for the R&D…." CSIS concludes that the most recent decline is "broad-based and not primarily tied to a few large development programs."
- In other words, neither "cancellation [n]or maturation into procurement account funding of major programs" accounts for the R&D spending decline. Instead, CSIS concluded that the

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cuts fell on "the stages of R&D that are critical to identifying and developing future critical technologies…." (The exception is that the gradual cancellation of the future combat system (FCS) accounts for the lion's share of the Army's decline in R&D contract spending between 2009 and 2012.)

- CSIS isolated the most steep declines in what it refers to as mid-to-late-stage R&D, which includes: advanced technology development , advanced component development and prototypes, and systems development and demonstration.
- One ray of sunshine snuck through the clouds. Sequestration appears to have reversed the trend, most pronounced from 2009 to 2012 (which is consistent with the Better Buying Power initiatives) toward more fixed-price contracting for R&D.

• A remarkable degree of stability can be found among DoD's 20 largest contractors in the new millennium.

- Lockheed Martin and Boeing held the top two spots in 2003 and 2013. General Dynamics, Northrop Grumman, and Raytheon rounded out the top five, but their positions have changed. CSIS points out Northrup Grumman's divestiture of Huntington Ingalls Industries (ranked seventh in 2013) as the most significant anomaly.
- Other contractors which have moved between the sixth and twentieth positions during that period include Dyncorp, General Electric, Health Net, Humana, ITT, L3 Communications, SAIC, and United Technologies.
- With the V-22's increasingly popularity, the Bell-Boeing Joint Project Office recently cracked DoD's top twenty. For leisure reading, consider Steven L. Schooner & Nathaniel Castellano, *Review Essay: Reading* THE DREAM MACHINE: THE UNTOLD STORY OF THE NOTORIOUS V-22 OSPREY*, by Richard Whittle, in Light of the Defense Acquisition Performance Study,* 43 PUBLIC CONTRACT LAW JOURNAL 391 (2014). General Atomics also found itself on the list. See, generally, RICHARD WHITTLE, PREDATOR: THE SECRET ORIGINS OF THE DRONE REVOLUTION (2014).

• The smallest contracts represent a smaller share of contract dollars, while the largest contacts have gained or absorbed a more significant share. CSIS observed that, under sequester, all sizes *except the largest* contracts experienced significant cuts. (Here's where statistics can be tricky. Elsewhere in these materials, authors have noted that, last year, the government – for the first time in ages – achieved the statutory twenty-three percent goal for small business participation. Of course, the total number of contract dollars awarded to small business decreased; small businesses simply enjoyed a slightly larger piece of a dramatically reduced pie.)

B. Change at the Top: Defense Policy and Aspiration. Last year at this time, we noted that Deputy Secretary of Defense Aston (Ash) B. Carter, formerly USD(AT&L), announced he would step down at the end of 2013. Now he returns as the Secretary of Defense. Many will remember Carter as the driving force behind the original Better Buying Power (BBP) initiative. *See, e.g.*, *http://bbp.dau.mil/*. Of course, BBP continues to evolve. BBP 2.0 offered more palatable themes, including encouraging the acquisition workforce to think, emphasizing the importance of a quality acquisition workforce and professionalism, and suggested a return to fundamental acquisition principles (including effective incentives to industry[;] ... understanding and active management of technical risk[;] ... demonstrated progress before major commitments; ... and … using the right contract type of the job). USD(AT&L) Frank Kendall's BBP 3.0 took a surprising turn, tilted heavily toward the micro rather than the macro, increasing the number of bullet points and reducing the size of the font on the summary Power Point slide. In many ways, BBP 3.0 feels more like a catch-all or a DoD-wide acquisition improvement wish list. Few topics disappeared, and many appear to have been added. Apparently in an effort to create a unifying theme or maintain some level of focus, two themes are trumpeted on the busy summary slide:

- Achieving Dominant Capabilities through Technical Excellence and Innovation; and
- Continue Strengthening Our Culture of Cost Consciousness, Professionalism, and Technical Excellence

Once the reader dives into the small print, BBP 3.0 emphasizes, among other things:

- Affordability caps and "should cost"
- Employing appropriate contract types and increased use of incentives
- Increased focus on (and control over) IR&D
- Increased use of draft technical specifications (and, hopefully, RFP's)
- Increased tradecraft in services
- Requirements definition
- Post-award contract management

Still waiting for the paradigm shift. Despite the post-millennium experience, BPP 3.0 does not appear to contain a silver bullet for enhancing the efficiency of future contingency contracting. *DOD Needs To Plan For Contractor Support As Key Part Of Contingency Operations, DSB Says*, 56 GC ¶ 269 (DSB "task force criticized DOD senior leadership for its continued failure to recognize [operational contract support] as critical to combat readiness [despite] 'years of discussion of controversial contract management issues, Congressional interest, numerous studies, and bureaucratic actions.'"); Defense Science Board, *Contractor Logistics in Support of Contingency Operations,* available at www.acq.osd.mil/dsb/reports/CONLOG_Final_Report_17Jun14.pdf.

C. DoD Continues Its Effort to Analyze Metrics. Last year, these materials suggested that the most thought-provoking reading of the year was found in DoD's nascent performance, outcome, or metrics, initiative. *AT&L Issues First Defense Acquisition System Performance Report*, 55

GC ¶ 214, *available at http://bbp.dau.mil/doc/Report_on_the_Performance_of_the_Def_Acq_System.pdf*. Fortunately, DoD followed up with a second report, and I hope we will see a third in 2015. *AT&L Releases Second Annual DOD Acquisition Assessment,* 56 GC ¶ 208; Office of the Under Secretary of Defense, Acquisition, Technology and Logistics, *Performance of the Defense Acquisition System: 2014 Annual Report*, available at bbp.dau.mil/docs/Performance-of-Defense-Acquisition-System-2014.pdf.

DoD has not received much credit for this effort and, surprisingly, seems to be generating more criticism than praise. That is a shame, because the reports are chock-full of intriguing observations and conclusions. Sure, there is room for improvement, but it seems wrong to focus exclusively on what the report could or should (eventually) do, rather than recognize that the first two reports remain a quantum leap forward in terms of transparency, analysis, and fodder for critical assessment. Like its predecessor, this is a lengthy, highly detailed report, with nuggets that should interest everyone. Against that backdrop, some highlights of the second report include:

- **Not all incentives work.** DoD concedes that contractual incentives are effective only if (1) the incentives are actually used; (2) the incentives are significant, stable, and predictable; and (3) the incentives are tied directly to DoD objectives.
- **"Cost-plus versus fixed-price" is a red herring.** DoD explains that the emphasis should be on matching incentives to the situation at hand instead of expecting fixed-price contracting to serves as a "magic bullet."
- **Incentive Fee Contracting - CPIF and FPIF.** DoD's data indicates that these contract types control cost, price, and schedule as well as, or better than, other types—and with generally lower margins.
- **Firm-Fixed-Price (FFP) Contracting requires knowledge of actual costs**. DoD explains that these "contracts provide vendors a strong incentive to control costs, especially in production, … [but] taxpayers do not share in those cost savings, unless the negotiated price took into account actual prior costs and margins, as well as the contractor's anticipated ability to continue cost reduction. [Accordingly], to use FFP contracts effectively, [DoD] must fully understand actual costs when negotiating subsequent production lots."
- **Competition is effective—But only when viable.** The good news is that DoD's data confirms that "[c]ompeted contracts perform better on cost, price, and schedule growth than new sole-sourced or one-bidder contracts in development.…Unfortunately, direct competition on some MDAP contracts is often not viable – especially in production, where significant entry costs, technical data rights, or infrastructure may be barriers.…"

Hopefully, the acquisition, oversight, budgeting, and planning communities will applaud DoD's efforts. Meanwhile these materials will continue to encourage DoD to evolve past a fascination with our longstanding, gen-

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erally unhelpful, and popular-primarily-because-they're-easy-to-measure metrics (price, schedule, performance specifications) associated with the award – rather than the outcome – of the contract. Specifically, increased attention to quantifying more meaningful measures such as *life cycle cost, bang for the buck*, *value for money spent,* and *customer satisfaction obtained* would be a step in the right direction.

Meanwhile, early data and analysis suggests that the most recent Congressional effort to manage the process has not proven itself as the proverbial silver bullet.

CRS Analyzes DOD Weapon System Acquisitions, Reform Options, 56 GC ¶ 198 ("Concerns over defense acquisitions generally center around significant cost overruns, schedule delays, and an inability to provide troops in the field with equipment they need when they need it"); *WSARA, BBP Helped DOD Improve Procurement, But More Work Remains, Witnesses Say*, 56 GC ¶ 148 (CRS's Moshe Schwartz indicated: 'a number of analysts believe that [WSARA] is having a positive effect,' but its full effect 'may not be felt until the next generation of weapon systems are in production' because of how recently the statute was enacted").

No doubt, there will plenty for us to discuss in 2015.