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THE DEPARTMENT OF DEFENSE AND INDUSTRY: DOES DOD EFFECTIVELY MANAGE ITS INDUSTRIAL BASE AND MATCH ITS ACQUISITION STRATEGIES TO THE MARKETPLACE?

HEARING

BEFORE THE

PANEL ON DEFENSE ACQUISITION REFORM

OF THE

COMMITTEE ON ARMED SERVICES
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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PANEL ON DEFENSE ACQUISITION REFORM

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THE DEPARTMENT OF DEFENSE AND INDUSTRY: DOES DOD EFFECTIVELY MANAGE ITS INDUSTRIAL BASE AND MATCH ITS ACQUISITION STRATEGIES TO THE MARKETPLACE?

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
PANEL ON DEFENSE ACQUISITION REFORM,
Washington, DC, Thursday, September 17, 2009.

The panel met, pursuant to call, at 8:00 a.m., in room 2237, Rayburn House Office Building, Hon. Robert Andrews (chairman of the panel) presiding.

OPENING STATEMENT OF HON. ROBERT ANDREWS, A REPRESENTATIVE FROM NEW JERSEY, CHAIRMAN, PANEL ON DEFENSE ACQUISITION REFORM

Mr. ANDREWS. Good morning, ladies and gentlemen. The panel will come to order.

We welcome our witnesses and members of the public to another in our series of hearings.

I would like to welcome our colleagues back from what I am sure was an eventful district work period in August. We are happy to be rejoining our mission here.

We began the work of the panel with a series of propositions that we wanted to pursue. The first of those propositions was to explore whether there are measurements that properly explore the difference between the cost that taxpayers are paying and the value that we are receiving for goods and services in the defense budget. We had a series of discussions about how to measure that difference, if any.

We then proceeded to a series of hearings that raise hypotheses about the reason for the gap between what we pay and what we receive.

This morning's hearing is another in those series of hypotheses. We have looked at a number of hypotheses before this. For example, we have looked at the fact that the rapid pace of development in the information technology field does not fit the procurement systems of the Department of Defense (DOD) at all, and, therefore, that misfit is leading to part of the problem. We looked at a number of other issues, as well. We looked at the development, or the lack thereof, of our workforce in procurement and so forth.

This morning, we are exploring the hypothesis that problems in the management of our industrial base lead to deficiencies or lead to gaps between what the taxpayer pays and what value those in uniform and the taxpayers receive.

Now, I will define the term "industrial base" to mean the enterprises which supply goods and services to the Department of Defense where the Department of Defense is a major customer, if not an exclusive customer, of that enterprise. It is a loosely defined term, but that is what we are going to mean when we say "industrial base."

The problem raised in the industrial base is, frankly, the opposite problem that we often grapple with in public policy considerations here. Much of the health care discussion, for example, is now centered around the issue of how do you deal with a marketplace where there are many, many, many purchasers but perhaps only one or two providers? It is a classic monopoly or oligopoly situation.

The problem raised in the defense procurement field for goods and services is the opposite. Perhaps it might be described as a monopsony problem, which, as a non-economist, I understand to mean a situation where there are a relatively high number of providers but only one purchaser. And that is, of course, the situation that we have here. By definition, a member of the industrial base, a company or enterprise that is in the defense industrial base is living in a world where his or her only customer, or major customer, is the United States Department of Defense.

Now, this raises a lot of problems. One problem is that if we don't demonstrate some long-term commitment to a contract, the enterprise in the industrial base doesn't have the security and the cash flow to sustain its physical plant and its workforce. If you are not sure from year to year whether you are going to get the work, you can't maintain the industrial base. On the other hand, if we do not induce the kind of competition that we want so there are many potential sellers to the monopsony buyer, you run into a situation where you lose value, you lose efficiency, and perhaps you lose quality, as well. So it is a classic problem.

I want to say from the outset, the premise of this hearing is not that the Department of Defense has done a poor job managing the defense industrial base. That is, in some ways, the question, not the conclusion.

And I also want to recognize the fact that this is a very difficult problem that is not easily managed. We don't want to split the Defense Department into several units and so we have many more buyers than one. That doesn't make any sense on a lot of levels. It is a difficult problem.

And so the purpose of this morning's hearing is to hear from some very experienced witnesses who know these issues to discuss for us their views on how we might better manage the defense industrial base, what the criteria for that better management are, what kind of solutions that we have seen employed in the past and what kind of problems that we have seen raised in the past.

We are going to look at workforce quality issues and workforce fairness issues. We are going to look at issues of technology. We are going to look at a number of different issues that fit this.

But suffice it to say, I am sure this will be an ongoing problem, to find that proper balance between a predictable set of expectations for enterprises in the marketplace but a sufficient level of competition among those enterprises so that the uniform personnel get the very best quality product and the taxpayer gets the best

deal. And that is the premise on which we are approaching this morning.

At this point, I would like to turn to my friend and colleague, the senior Republican member of the panel, Mr. Conaway, for his remarks.

STATEMENT OF HON. K. MICHAEL CONAWAY, A REPRESENTATIVE FROM TEXAS, RANKING MEMBER, PANEL ON DEFENSE ACQUISITION REFORM

Mr. CONAWAY. Well, thank you, Mr. Chairman. I appreciate it.

Good morning, gentlemen. Thank you for being here this morning. I appreciate that.

We had asked Kellog, Brown, and Root (KBR), another provider, to actually come and testify this morning. They are unable to be with us, so I would ask unanimous consent to submit their written testimony for the record.

Mr. ANDREWS. Without objection.

[The information referred to can be found in the Appendix on page 89.]

Mr. CONAWAY. As the chairman said, this is a very important subject. One of the issues that concerns me is that the Department seems to operate under the assumption that we will always have an industrial base that can meet their changing requirements. This is particularly an issue in a budget-constrained environment.

And although Secretary Gates is quoted as saying that the industrial base concerns played no role in his 2010 budget decisions, the new Under Secretary of Defense for Acquisition, Technology, and Logistics, Dr. Carter, has indicated that he intends to elevate industrial base concerns within the Department of Defense.

This is reassuring because there is no doubt that defense strategy has a significant impact on the industrial base. It is one of the reasons, I believe, that we need to carefully look at the pending Quadrennial Defense Review to ensure we minimize any potential consequences of undermining or impairing the defense industrial base's ability to meet the future needs of the Department.

I am puzzled on the word "manage," Mr. Chairman, that you had used, that it is actually the role of the Department of Defense to manage the industrial base. I am going to chew on that one. "Manage" typically means you have total control over it and you are managing those resources. And I have to think about that one.

My other concern, which the chairman has appropriately highlighted in the past and this morning, is in regards to the aging workforce, particularly in the field of engineering. We have the most modernized industrial base in the world, but without the properly trained workforce, we are not going to be able to produce much.

I look forward to our witnesses' testimony, and I look forward to our discussions on these issues.

Thank you, Mr. Chairman.

Mr. ANDREWS. I thank my friend.

And I appreciate his comment on the word "manage." It probably is an inartful word. The meaning I was wanting to convey was to put in place a set of policies that achieve the twin goals that I

talked about, of stability for the enterprises and quality and best value for the taxpayer. I think your improvement is a correct one.

I do want to note that we are joined this morning by a member of the full committee who is not a member of the panel but, as all members of the full committee, is welcome to join us. That is Congressman Patrick Murphy from Pennsylvania, who, several months ago, suggested that the panel focus on issues of the quality of the workforce and the fairness to the workforce, which I think are intertwined, and we have some discussion on that this morning.

So thank you, Patrick, for your participation.

I want to proceed by introducing our four witnesses.

I think you are all veterans of this process, but I would remind you that your written statements, without objection, are being made a part of the record of the hearing. We would ask you to synopsize those written statements in about five minutes. And we would ask you to stick to that five minutes so we can then have questions-and-answer time with the panel, which I think we find is the most productive part of the hearing.

I am going to start with—I am going to read each of the biographies. And when I have completed each of them, we will start, Mr. Soloway, with your testimony.

Stan Z. Soloway is the president and Chief Executive Officer (CEO) of the Professional Services Council (PSC), the principal national trade association of the government professional and technical services industry. PSC is widely known for its leadership on the full range of government acquisition, procurement, and outsourcing and privatization issues.

Mr. Soloway assumed the presidency in January of 2001. PSC has a membership of over 330 companies of all sizes performing services of all kinds for virtually every agency of our government.

In recognition of his leadership while he served in the Department of Defense in his illustrious career, Mr. Soloway was awarded both the Secretary of Defense Medal for Outstanding Public Service and the Secretary of Defense Medal for Distinguished Public Service while serving at the DOD.

Mr. Soloway earned his degree in political science from Denison University, where he was elected to the national men's journalism, national men's leadership, and national political science honorary societies.

Welcome, Mr. Soloway. It is great to have you with us.

We are joined this morning by Richard K. Sylvester, who is the vice president for acquisition policy of the Aerospace Industries Association (AIA).

Mr. Sylvester joined the Aerospace Industries Association in August of this year. He is heading AIA's Procurement and Finance Division, responsible for directing the development and coordination of the association's positions on proposed procurement-related legislation, regulations and their implementation.

Mr. Sylvester served in the Department of Defense in a number of capacities for 35 years, prior to joining the AIA, most recently as Deputy Director of the Acquisition Resources and Analysis for Acquisition Management in the Office of the Under Secretary of Defense for Acquisition.

You must have a very large business card.

Mr. Sylvester graduated from the University of Michigan—so he must be happy with last weekend's football results—with a Bachelor of Arts (BA) in political science and economics.

Welcome, Mr. Sylvester. We are glad that you are with us.

We have with us Mr. Robin "Pug" Gutridge. As president of Cherokee Information Services, Mr. Gutridge oversees a highly successful information technology and management services company that supports the government and private sector.

Mr. Gutridge came to Cherokee in 1998 after a successful career in the United States Coast Guard, where he graduated from the U.S. Coast Guard Academy and served as a helicopter pilot, engineer, and acquisition professional.

He is also active in various organizations such as the United States Chamber of Commerce, TechAmerica, and the Association for Corporate Growth. In these organizations he serves on a number of committees, all related to improving the manner in which business is conducted and services are provided.

Mr. Gutridge, thank you and welcome.

And, finally, Dr. David Madland is the director of the American Worker Project at the Center for American Progress. He has written academic articles, books, op-eds, and commentaries on a range of economic issues, primarily focused on retirement, jobs, and public opinion.

He has a Doctor of Philosophy (Ph.D.) in government from Georgetown University and received his Bachelor of Science (BS) from the University of California at Berkeley.

Prior to joining American Progress, David helped lead a range of advocacy campaigns as a consultant to labor unions and environmental organizations. He worked for Congressman George Miller, now chairman of the Committee on Education and Labor, on which I serve.

And we are very happy to welcome David to be with us here this morning.

So, gentlemen, we are going to ask if you would begin your testimony. As I said, your written statements have been accepted as part of the record.

Mr. Soloway, we will begin with you.

STATEMENT OF STAN Z. SOLOWAY, PRESIDENT AND CEO, PROFESSIONAL SERVICES COUNCIL

Mr. SOLOWAY. Thank you, Mr. Chairman, members of the panel. It is really an honor to be here. And I do want to say that the focus of this hearing and the topic you have chosen is a very important one. I think you have captured—both you and Mr. Conaway—captured very well the importance of the discussion that has to take place.

Let me start by suggesting that we don't have an industrial base; we have multiple industrial bases. And even represented at this table you have two separate bases. Where I am going to focus my conversation, you have the industrial base that is primarily responsible for the manufacture and development of major weapons systems on the hardware side, and then there is a services industry, a professional services, technology services industry. And while they are very much integrated in many ways, they also are very

separate and have very different dynamics. And I will address some of that in my testimony, and a little bit more detail, of course, is contained in my written statement.

In fact, the Defense Department has for a long time focused on impacts on the defense industrial base of many of its actions. There is an Office of Industrial Affairs that is primarily set up to do that in the Defense Department.

At the same time, the Department spent over $180 billion last year on services, 40 percent or more of its total contract spending, yet it has invested relatively little time in really understanding and developing a keen awareness of the dynamics and structure of the services industrial base on which it so significantly relies.

In other words, even as we have been trying, appropriately so, to build better oversight of services contracts and services contracting in the Department, our insight into the supplier base that are performing on those contracts at the Department level remains limited.

With regard to the base itself, the services industrial base, in 2006, the Center for Strategic and International Studies (CSIS), with the strong support of PSC, undertook the first-ever analysis of the federal professional services industry. This had actually never been done before. The CSIS study is available on our website. I believe we have some copies here with us today. But there are several key insights that they found that I want to share.

Number one, the services sector is incredibly diverse, both in terms of size and in terms of capability.

Second, more than 70 percent of the contracts in the services sector in the Federal Government are competitively awarded; that is, competitive to the extent that there are at least two, if not more, bidders on each of those procurements.

Third, the growing use of large multiple award contracts, under which companies must compete to get on the contracts and then compete again to get task orders under which the actual work is performed, has driven up transaction costs for everybody in the marketplace, with a particular impact on small and mid-tier firms for whom those costs are particularly precious.

And, finally, for a variety of reasons, there has been real pressure placed on the mid-tier of the marketplace. If you have a natural market cycle of small, mid-tier, and large, the mid-tier of the services market is under pressure. In some segments, particularly IT services, the market share reductions have been as much as 40 percent.

The Defense Department did utilize the CSIS study to do some internal analysis of its own share of the professional services market, but, to date, not much has been done with those analyses. Yet the Department and, to some extent, Congress continues to promulgate new policies, regulations, and laws that will impact that industrial base, absent that detailed understanding of those impacts. And we believe that ought to come—the cart before the horse.

On the policy side and actions taking place within the Defense Department, there are really three things that I want to very briefly touch on.

Number one, small and mid-tier business. The government has a presumption in all government procurement that says you are ei-

ther small or other than small. That is the only distinction drawn in federal procurement as to the size of companies. Yet, as the CSIS study told us, as Mr. Gutridge's company is a good example of, there are multiple tiers within the services sector in each size category. So just this binary view immediately starts you from a presumption that does not reflect the reality of the market.

Second, some people, increasing numbers of people in small businesses, particularly entrepreneurial technology-based companies, mid-tier companies, are beginning to question the premise of our small-business programs. Not that they disagree with them, but what is the goal? Is it to create small businesses? Or is it to create sustainable small businesses that have the ability to grow to the extent of their capabilities and ambitions?

That actually may sound like a fine distinctions, but it is a very critical distinction, because our focus has been on the former, which is to create businesses, and less on the latter, what are we doing to foster growth and development beyond the size standards as they exist.

Mr. Chairman, you mentioned the workforce issues as a very critical element of understanding the dynamics of the industry. Because the fact is that industrial-based issues principally revolve around as, in any business relationship, risk and risk management. What are the risks? What are the predictable elements? What are the nonpredictable elements? And how do I manage those? And, as a customer, you have to understand how your supplier base defines, manages, and identifies risk. That is not a core component of the acquisition training in the Defense Department today for people doing services acquisition, and we think it should be a core component of that training.

Finally, there is a number of specific policy initiatives under way today that bear some discussion. And in my written statement I mention three: in-sourcing, organizational conflicts of interest, and fixed-price contracting—three very disparate kinds of policy issues in how we think they actually have an industrial base effect. In the interest of time, what I would like to do is just touch on one, and that is the in-sourcing question.

In-sourcing is very much an issue of industrial base concern. And, Mr. Chairman, I think you captured it very well in your opening statement when you talked about predictability in competition. We have a marketplace in services that is highly competitive. But in-sourcing, if it is done wrong, completely destroys that competitive base because we are no longer competing; the government is acting in a monopoly manner, just taking work. And, second, it destroys the predictability in the marketplace. It creates risk, it creates uncertainty. It breaks down partnership trust and relationships. So it is an industrial base issue.

The Secretary has set a goal, the Secretary of Defense, of realigning and rebuilding critical skills in the Defense Department. That is one stream of in-sourcing we have heard a lot about. We are very supportive of that initiative. While we may disagree on the specific elements of how it is done, it is an initiative that is important. We all recognize that there has been a falloff in skill sets, particularly in acquisition. So we do not object conceptually and, in fact, would support strategic looks at how we can rebuild that workforce.

But the other in-sourcing that has taken place in the Department, or beginning to emerge in the Department, some of it driven by legislation which instructed the Department to consider in-sourcing a variety of functions—not a mandate, but to consider—and then budget bogies that have been given to the military services are driving an entirely less strategic and, I think, less beneficial behavior.

For example, on the legislative side, Office of Management & Budget (OMB) has put out a memo on July 29th directing how to implement congressional direction and does a very good job of defining the term "consider." Makes it clear this is a source-neutral decision, that this should part of your thinking, should we perform the work in-house or should we perform it by contract, and then lays out a number of decision levels that you have to go through to make that decision.

That discipline, at this point, does not appear to be taking place within the Department. I am not blaming this on the secretariat, because they have been primarily focused on the workforce rebuilding part, which is a whole different decision. That is a strategic human capital initiative.

But as you have this in-sourcing taking place in the field, where people perceive it either to be a mandate or not doing full-cost analysis where they really look at what is the cradle-to-grave cost to the government. Across the board, not just your own personnel line or your own benefits line, but what are the infrastructure costs that somebody else is absorbing? Who is paying for the lifetime health care? Who is paying for workforce development? How do I know I am getting the right skill at the right place? It might be slightly less expensive, but maybe I need actually a higher level of skill, for which the marketplace has determined there is a higher value to that skill and so forth. Those analyses, to the best of our knowledge, have not been done.

In fact, what is happening in many services is they have declared outright that for every position that the service in-sources, the service is taking a 30 to 40 percent savings per position. And our question is, based on what? If I have a contract—and Mr. Gutridge could speak to this much better than I since he has this situation—if I have a contract and I have 75 people performing on that contract, and you look at that cost and then say, "Well, by person by person, here is what I think I could save by in-sourcing it," I have immediately walked away from the fundamental premise of business, which is competition. What if I said to the marketplace, "I need to reduce my costs here. What is the marketplace adjustment going to be?" I could maybe do it—my person by person costs might be higher, but I might be doing it with fewer people, with better technology, more agility, on a performance basis where I can actually move people around.

So there are all of these factors that go into a good business decision that have huge impacts on the industrial base's ability to do business with the Defense Department which we are concerned the current in-sourcing trend is stepping away from. And there are fundamental premises that I think we ought to focus our attention on.

Final point—I apologize—one last point on the in-sourcing is there is great concern amongst many companies about the degree

to which the government is today overtly targeting and soliciting contractor employees.

And let me be very clear: There are a lot of people in government who have suggested for years that contractors hire government employees and simply bill them back to the government, sometimes at higher rates. I am not sure the extent to which that actually happens, but I can tell you from an organizational perspective, all 350 member companies, we would agree that that is inappropriate in that case, and it is inappropriate when you do it with our folks.

Where there is a direct business relationship, where you have me under contract or I have you under contract, we should not be soliciting each other's employees. In the private sector, that is anathema. There are nonsolicitation, nonpoaching clauses routinely across private-sector relationships to protect the integrity of the relationship.

But, nonetheless, what we see is a very aggressive effort on the part of the government to do just that. And we find that both high-cost to companies, unfair interference with employee-employer relationships. And, frankly, it raises real questions about the merit system's hiring process and whether they are actually circumventing established rules which this full committee has made clear to the Department they expect them to follow.

So I think that is another stream here that is important to address and does have impacts on companies like Mr. Gutridge's, bigger companies, and even smaller companies.

So, Mr. Chairman, thank you again very much for the opportunity. And I look forward to the questions when we get finished.

[The prepared statement of Mr. Soloway can be found in the Appendix on page 35.]

Mr. ANDREWS. Thank you, Mr. Soloway.

Mr. Sylvester, welcome to the committee.

STATEMENT OF RICHARD K. SYLVESTER, VICE PRESIDENT OF ACQUISITION POLICY, AEROSPACE INDUSTRIES ASSOCIATION

Mr. SYLVESTER. Thank you very much. Chairman Andrews, Congressman Conaway, members of the panel, on behalf of Aerospace Industries Association, our 300 manufacturers and suppliers of defense aerospace equipment and supplies and our over 800,000 workers, I appreciate the opportunity to come before you today and talk to you about some issues that we think are very significant.

My written statement contains a lot of information about some of the things we are considering. I just want to make a few key points this morning.

AIA is supportive of major acquisition reform initiatives that advance the stability of programs and requirements, expand workforce skills and experience, and provide better contract incentives to reward good performance, enable firms to attract capital and earn fair returns on contracts.

By institutionalizing such changes and obtaining more affordable and predictable acquisition outcomes, the acquisition system will become more transparent, predictable, and cost-effective. To that end, the recently passed "Weapons Systems Acquisition Reform Act," which your panel was part of creating, was a step in the right direction.

AIA also believes that a dedicated effort should be made to encourage more, not less, dialogue between DOD, industry, and Congress on acquisition industrial base matters.

Furthermore, the government should resist the creation of new barriers to the employment of qualified acquisition personnel, many of whom come from industry and understand the many challenges and opportunities to implement improved acquisition procedures. Flexible rules that preserve program integrity, while allowing for the recruitment and retention of a well-trained and experienced acquisition workforce, should be our common goal.

Although there are multiple areas in which defense acquisition could be improved in coming years, AIA recommends that the government focus primarily on three overarching goals.

The first goal is to promote stability and fairness in contracting and financial policies. In order to maintain a competitive industrial base that effectively supports the warfighter and the Nation, AIA urges the government to promote contracting and financial policies that offer the opportunity for reasonable returns and cash flow in the industry's performance of government contracts.

Such reform should be based on good performance. Contracting and financial policies that offer the opportunities for reasonable returns for good performance would: one, make companies more likely to invest in independent research and development and make capital expenditures; two, provide for reasonable base fees and hire available award and incentive fees, giving industry a reasonable chance of earning a fair return; and, three, prohibit fixed-price options before design reaches an acceptable level of maturity and stability.

The second goal is to reform the major elements of the defense acquisition system. Government and industry agree, there is a major disconnect in the defense acquisition process between requirements, programs, and budgets. This critical element of the defense acquisition process must be repaired.

Former Under Secretary of Defense for Acquisition, Technology and Logistics John Young reviewed major defense acquisition programs and identified three key contributors to the problem: inaccurate cost estimates at the beginning of the program; requirement instability during the development of the program; and budget instability through the development and acquisition process.

These three areas must be effectively addressed to further restore confidence in DOD's acquisition system. Again, the recently passed "Weapons System Acquisition Reform Act" addressed stability for budgets, cost realism, and requirement stability, but there is more work that needs to be done there.

The third and final goal is to promote the competitiveness and efficiency of the aerospace and defense industry. The defense business is increasingly taking on a global character. Competitiveness and efficiency should be promoted within this market by ensuring access to the best sources in the global supplier base. We are the best at what we do, and we do not fear competition with other nations. This is demonstrated by the $60 billion trade surplus which our industry enjoys, a trade surplus surpassing any other manufacturing industry. Government policies designed to correct perceived deficiencies in the contracting process or protect specific U.S.

sources could undermine that competitiveness and diminish our industrial base.

AIA is also concerned with recently enacted tax provisions, such as the 3 percent tax withholding on every government payment to contractors, which the DOD itself estimates would cost the American taxpayer $17 billion over 5 years.

Other items that hinder efficiency and effectiveness in competition include barriers to the commercial marketplace such as demands for detailed cost data from commercial item suppliers and expert controller regime that punishes our allies and drives technology development overseas.

The requirements for our national security have not changed. The threats from many sources remain, along with the need to modernize, recapitalize, and reset our equipment. In order to maintain a competitive industrial base that effectively supports the warfighter and the Nation, the government must promote balanced, stable, and fair contracting and financial policies that offer the opportunity for reasonable returns and cash flow in the industry's performance of government contracts.

Industry acknowledges that such reforms should be based on good performance. In today's resource-strapped environment, industry takes its role to be a responsible acquisition partner seriously.

Thank you, and I would be happy to answer your questions.

[The prepared statement of Mr. Sylvester can be found in the Appendix on page 49.]

Mr. ANDREWS. Mr. Sylvester, thank you very much.

Mr. Gutridge, welcome this morning.

STATEMENT OF ROBIN "PUG" GUTRIDGE, PRESIDENT, CHEROKEE INFORMATION SERVICES, CHAIRMAN, TECHAMERICA

Mr. GUTRIDGE. Thank you, Mr. Chairman.

Good morning, Chairman Andrews and Ranking Member Conaway, members of the panel. I am honored to be here today representing TechAmerica and provide you with our thoughts on a little bit more focused area, and that is on the acquisition of technology at the Department of Defense.

The most important point I want to make to you today is that the Department of Defense and the rest of the U.S. Government, for that matter, seems to have moved away from the tenets Congress adopted in the last 10 to 15 years: to make acquisition of commercial and cost items easier and more affordable.

Now, agencies are moving towards an environment that requires government-unique items in both the requirements placed on the products and services being acquired and in the terms and conditions under which the acquisitions can occur.

We believe, if we continue down this path, the government will find it increasingly difficult to attract and retain commercial IT and technology providers and, subsequently, to unearth and utilize the kinds of innovation we see in the commercial market today.

One of the main reasons for this is because the DOD role in the global Information Technology (IT) marketplace is diminishing, which leads to decreased competition. Currently, it accounts for less than one-tenth of 1 percent. So incorporating the government-

unique requirements I mentioned previously will only make it more difficult for a company to enter the DOD or government market to support and sustain a presence.

Another reason is because DOD acquisition of technology takes a significantly longer time period than the commercial product lifecycle and is vastly different from the commercial buying process. Because technology refreshes at a minimum of every 18 to 24 months, a commercial acquisition best practice is to identify the products and/or services by them and deploy them in less than 24 months. The time frame is feasible because market research, due diligence, and presolicitation processes are much more open to dialogue and establishing trusted relationships than in the federal acquisition process.

The current buying practices of the Department also disguise its presence in the commercial marketplace. Although DOD spends a considerable amount of its budget on IT, the average contract action size is reduced from nearly $2.5 million in 2000 to $204,000 in 2007. So this fragmented buying practice, coupled with the increased risk for commercial companies and the rising cost of winning and sustaining contracts, has diminished the attractiveness of the DOD market space.

We also have significant concerns that the erosion of the acquisition workforce is making the DOD less able to keep pace and deploy innovative solutions. We have seen an increasing ratio of contract transaction numbers and size to the number of employees. But, as Stan pointed out, the CSIS study talks about that. And we see a significant increase, almost a trebling, in the number of transactions per the number of employees.

But we have also seen a significant decline in the numbers of that workforce who had the adequate skills to understand complex information systems. Attracting the best and brightest workforce is crucial to the development of adequate requirements, which leads to the creation of effective systems and enterprise-wide solutions.

The last point I wanted to note is the increasingly risk-adverse environment under which we are currently operating, which only leads to decisions based largely on avoiding risk. Instead, we believe that the acquisition practices should be aligned to reward actions to acquire IT services or products in a timely, cost-effective matter. We must find a way back to a more open environment that creates incentives and rewards for the acquisition workforce and the contracting community to produce outcomes based upon best value for the warfighter and the taxpayer.

Thank you again for the opportunity to provide our perspective, and I look forward to answering any questions.

[The prepared statement of Mr. Gutridge can be found in the Appendix on page 68.]

Mr. ANDREWS. Mr. Gutridge, thank you. And thank you for your service to our country.

Dr. Madland, welcome.

STATEMENT OF DR. DAVID MADLAND, DIRECTOR, AMERICAN WORKER PROJECT, CENTER FOR AMERICAN PROGRESS ACTION FUND

Dr. MADLAND. Chairman Andrews, Ranking Member Conaway, thank you very much for having me. I am David Madland, Director of the American Worker Project at the Center for American Progress Action Fund. I am pleased to be a part of this panel and applaud your ongoing efforts to ensure that taxpayers receive good value for their federal contracting money.

While the center has advocated a range of reforms to achieve these goals, including increased competition, strengthening the acquisition workforce, and preventing the contracting out of essential government functions——

Mr. ANDREWS. Mr. Madland, I am sorry. I think your microphone may not be on.

Dr. MADLAND. The light——

Mr. ANDREWS. Okay. I wonder what procurement process we used to buy the microphone. Okay. I just want to be sure the members and the audience can hear you.

Dr. MADLAND. All right. We are back.

I want to focus on a less well-known but equally critical issue: the pay, benefits, and working conditions of the low-wage contracted workforce.

In my testimony, I want to make three main points. First, many federally contracted workers have low-quality jobs. The workers I am talking about sew military uniforms, rebuild Army bases, provide security for secure facilities. And, second, while poor treatment of workers is an important problem in its own right, much more to the point of this panel: limited benefits, low pay, poor working conditions can impose costs on the government and taxpayers and make it hard for high-road companies to compete. Third, promoting higher labor standards can be part of a strategy for ensuring better value in contracting. Let me elaborate on each of those points.

First, the scope of the problem. I want to emphasize that the data are rough because the Federal Government doesn't keep or make publicly available quality data, but all the evidence points in the same direction. For example, estimates from the Economic Policy Institute indicate that about 20 percent of all federally contracted workers earn poverty-level wages. This means one out of five workers on a Federal contract do not earn enough to keep a family of four out of poverty. And low wages and inadequate benefits are much more common in some contracted industries, according to Paul Light, a professor at New York University (NYU).

Not only is pay quite low for many contracted workers, but working conditions are often of low quality, with contracting companies frequently violating labor laws.

Second, these kind of working conditions can cause taxpayers to receive less than full value. When workers are poorly compensated on the front end, taxpayers often bear additional costs on the back end, such as for Medicaid, Earned-Income Tax Credit, and food stamps. Furthermore, research finds that when contractors cut corners to their workers, they often cut corners in the final products they deliver to taxpayers, which imposes additional costs.

Third, promoting good workplace practices can be a good value for taxpayers. Not only can they reduce these unintentional subsidies, but it can also promote increased competition and reduce the likelihood that companies will operate in a wasteful fashion.

Let me just give you one example. The State of Maryland implemented a living-wage standard recently, and the Legislative Analyst's Office did this study. And they found that the average number of bids for contracts in the State increased nearly 30 percent, from 3.7 to 4.7 bidders per contract.

They went out and surveyed the companies. Nearly half of contracting companies interviewed by the State said that the new labor standards encouraged them to bid because it leveled the playing field. Several of the companies commented that in the future they will only bid on these kinds of contracts with the higher standards. And one contractor noted that her current contract was the first that she had ever bid on with the State because she explained that, without strong labor standards, quote, "The bids are a race to the bottom. That is not the relationship we want to have with our employees."

Now, over the past decade, state and local governments have been leading the way to promote higher standards for the treatment of contracted workers, as an excellent report by the National Employment Law Project makes clear. To build on these models and improve the treatment of the contracted workforce and promote better value for the taxpayers, there are many steps Congress can take, but I want to just highlight two of the most important.

First, to limit the number of contracts that are awarded to low-road companies, the Federal Government should ensure that it only does business with responsible companies by doing a better job of screening companies based on their overall regulatory record, including their compliance with labor laws. And, second, the contracting process should promote higher labor standards by evaluating proposals based in part on the quality of jobs they provide for workers.

These kind of reforms would be the right thing to do for workers, but they will also improve accountability and increase transparency, while limiting wasteful contracting and helping ensure good value for taxpayers.

I want to thank the panel for its time and consideration and express my willingness to work with you on these reforms.

[The prepared statement of Dr. Madland can be found in the Appendix on page 75.]

Mr. ANDREWS. Dr. Madland, thank you very much.

I would like to thank all the witnesses. And we will begin with the question time.

Mr. Soloway, you made reference to the additional costs that we incur with multiple award task order contracts. And, certainly, the more transactions that have to take place in the procurement process, the greater cost that is added.

What about the benefits of it, though? Isn't it accurate that, if companies not only have to compete for the right to provide the services but the actual provision of the services from time to time, that that adds more value than it subtracts?

Mr. SOLOWAY. It is certainly correct that it can. And I didn't mean to suggest that multiple award vehicles are the wrong kind of vehicle. I think maybe if I were to recast my comment, it would be: For many years, we have been moving in this direction of getting a group of companies to compete to get on the contract, and then as each requirement comes up they compete again. And it has been generally accepted as a good, competitive model and enables the government to buy more incrementally rather than always buying one large package at the same time. So it has had some great benefit.

What has happened in recent years, at least amongst our membership which includes a lot of IT and IT services firms and others, is the dramatic growth in these vehicles and some real questions of how much redundancy we are going to have in this system. How many times do I have to compete to offer the same capability to the government, 30 times, 40 times? Each agency wants its own contracts to do everything.

And so it is an additive issue, not the fact of the multiple award vehicles, if that makes sense. It is that the number of them has grown so greatly, it has now created some real cost and price pressures on everybody and questions of diminishing returns, I think, as well.

Mr. ANDREWS. So perhaps a procurement regime where there is more jointness, where each agency does one set of procurement actions rather than multiple, would solve the problem.

Mr. SOLOWAY. Well, that might help. I think more, kind of, the shared services approach that started a few years ago has some benefit.

But we also have to be very careful, because the other impact of multiple award contracts, which is really a management issue for the Department—I am not sure that we in the industry have all the answers, or the Congress or what have you—is that, very often, these large contracts have 15 or 20 different capabilities you have to demonstrate to get on the master contract.

Well, for small and mid-tier firms, many of them have four or five terrific capabilities, but they don't have 15 or 17, so they might not even qualify to get on the initial vehicle. So balancing that out becomes a real issue.

Mr. ANDREWS. I see. Thank you.

Mr. Sylvester, you testified a concern about—which I think it is self-evident—of having a reasonable rate of return for companies so they can attract capital in fixing the price of these contracts.

Is there any evidence that companies in the defense manufacturing field are having trouble raising capital?

Mr. SYLVESTER. There are a number of cases that we have seen that have come out of DOD that have decreased payments of fees and where work needs to be done or certain things need to be done after the actual manufacturing work has been done. So that becomes a cash-flow problem for us, which reduces our rates of return. And that becomes an issue as you look at the capital markets.

Mr. ANDREWS. I certainly understand that an unexpected cash-flow problem makes a company less profitable, which therefore makes it less attractive. But are there generic trends in the equity

markets or the bond markets that say it is harder for these firms to attract capital?

Mr. SYLVESTER. I don't believe that that is the case, although the rates of return that we are seeing, as you look over the time frame, you will see that there are smaller rates of return on a lot of these companies.

Mr. ANDREWS. Do you know off the top of your head—I wouldn't expect you to, but if you could supplement the record, I would appreciate it—how many of your members are closely held and how many are publicly traded? Do you know?

Mr. SYLVESTER. I don't know, but I can give you that figure.

[The information referred to can be found in the Appendix on page 97.]

Mr. ANDREWS. Is it mostly publicly traded?

Mr. SYLVESTER. A lot of the larger companies are certainly publicly traded.

Mr. ANDREWS. Okay. If you could just supplement the record, I would like to know.

Mr. Gutridge, I think you made a compelling case about how a very tiny portion of the global market becomes the tail wagging the dog, right? So that if most of the marketplace you are working is not DOD procurement but you have a set of what I think you called government-specific requirements, that makes it unattractive to bid on those jobs.

What are some of the government-specific requirements you are talking about that you think make the bid unattractive?

Mr. GUTRIDGE. I think two right now are causing a lot of uneasiness. One is certainly the security requirements. And, again, we believe that there needs to be particular attention paid to the overall security issue. But, again, making that——

Mr. ANDREWS. Do you mean background checks on employees, or do you mean security where the product is handled?

Mr. GUTRIDGE. Security of the product itself. So a piece of technology has a certain capability or it doesn't have a certain feature. So that is one particular area.

Mr. ANDREWS. Don't you think that is kind of inevitable, though, I mean, given the nature of the work that we are doing here?

Mr. GUTRIDGE. Well, we think it is. And, again, we think, in many cases, that is kind of application-specific, if you will. And we would encourage that, that those types of measures continue in that area.

The second area has to do with the origin of the particular technology, kind of gets wrapped into the Buy America Act. And, again, it kind of is subtly introduced into the whole notion of security—malicious code, backdoors, those types of things being written into the software.

So, again, for large global companies that basically see this as a huge cost driver, they see this, again, as an increased cost into a marketplace that has more and more uncertainty and appears to be a lower, lower portion of their potential revenues going forward.

Mr. ANDREWS. I understand.

Dr. Madland, I will conclude with you. If we were to be more aggressive in debarment of contractors that were violating labor laws and other type regulations, where should the standard be set for

a violation that results in debarment? You know, putting it in layperson's term, you don't put a person in prison for jaywalking, but you do put someone in prison for rape or murder. Where is the line between jaywalking and rape or murder?

Let me just play devil's advocate. It is fairly easy to have an Occupational Safety & Health Administration (OSHA) violation if you put the wrong form on a bulletin board. I think most of us would agree that there is no way that should disqualify a company from consideration. However, if you have had several fatalities because of careless or reckless practices, that is debarment.

Where should the line be drawn?

Dr. MADLAND. I think you are asking a very good question, but, first, let me be clear: I am not advocating for a different kind of debarment process. Certainly, what I am advocating for are two things.

First is a better screening process. This is for responsible contractors; the law is that we are supposed to only do business with responsible contractors and supposed to look at their track record. Labor law is usually not—it could be part of that evaluation process, but it is usually not. The database that is going to go online is a big part of that. And that is something that contractors will look through and evaluate.

There is clearly no black-line standard you can make because, also, for different kinds of contracts, it is going to be different. You know, for example, if you are having security guards guarding a kind of facility, if they are repeatedly hiring people with criminal records or something like that, that is going to be a more significant kind of problem than if they had one OSHA violation.

Mr. ANDREWS. So you are saying you think the standard is clear, but we are not doing a very good job evaluating?

Dr. MADLAND. No, the standard is actually not clear. The contracting officers could definitely benefit with increased clarity. And they could also benefit with better tools with which to make the determination.

So, for example, the database that is going to go online will not capture most labor law violations, for many reasons, but the two most important are that the fines for most labor laws, like the violation of minimum wage or the right to organize, are not fines that are high enough to reach the threshold of the database. They are also often settled without a finding a fault, and finding a fault is necessary to be part of the database.

And then the second thing, to be clear, that I am advocating for is, once a company is bidding for—so they have been found responsible, they are bidding on a contract, I think we should evaluate the wages and benefits they pay their contracted workers. And, again, that is on a sliding scale, not a black line.

Mr. ANDREWS. Okay. Thank you.

I am going to turn to Mr. Conaway for his questions.

Mr. SOLOWAY. Mr. Chairman, is it appropriate to make a comment?

Mr. ANDREWS. Briefly, if you would. I want to make sure we get to the other members.

Mr. SOLOWAY. Thank you. I just want to make two quick comments because I think the issue here is really a very complex one.

You touched on one critical issue, which is how do you make the judgment of where the line is. And we are going to have a database online at some point that is supposed to have a company's entire record of behavior with regard to Federal law. And contracting officers are going to be asked to make decisions that are exactly the kind of decisions—are you responsible—if you have had nine labor law violations in a company with 40,000 employees over 4 years versus a company that had a tax violation 3 years ago and so forth. So the line is a very critical one.

But the point that was missed here and I think is really important is that—I mentioned earlier separating out the different elements of the industry. In construction and in services, there are prevailing wage laws that govern the wages, set by the Department of Labor, that tell contractors what they must pay and what their health and welfare benefits must be. And the penalties for violating the law are actually fairly significant.

The second thing is, both are so complicated. Both the Department of Labor and industry will tell you they are incredibly complicated. We put hundreds of people a year through training programs that we run to help them comply with the Service Contract Act, that violations of the act are most often completely unintentional, yet they go into the record as a violation.

So I think Dr. Madland's overarching point of responsible contractors paying good wages and good benefits is the absolute right one, but I don't think we can have that discussion without looking at the underpinnings of current law that guide that, with regard particularly with services and construction.

Mr. ANDREWS. Understood. Thank you.

Mr. Conaway.

Mr. CONAWAY. Thank you.

Let's look at the defense acquisition system itself. Can you look at it from two perspectives? What are the top three problems with the system? And then what are the top three problems the system causes those of you that are trying to deal with the Federal Government? And it may be the same question, but just take a shot at it. What are the top three things you would fix?

Mr. SOLOWAY. I think—and I suspect I am speaking for all our colleagues here—that number one is the workforce issue. There is no question that the Defense Department has experienced substantial workforce atrophy over the last decade and a half.

I had some responsibility for the acquisition workforce when I was in the Pentagon. I worked with Rick on the issues for many years. The workforce——

Mr. CONAWAY. Is that because of that system, though, or is that just——

Mr. SOLOWAY. I am sorry?

Mr. CONAWAY. The workforce atrophy, has that been caused by the system? Or is that just the fact that the baby-boomer bulge that came through the entire defense industrial complex is now——

Mr. SOLOWAY. I think part of it is the demography, just what you said. But I think the other issue is that, as the Department of Defense was downsizing in the early to mid-1990s—we had a 38 percent reduction in workforce across the Department of Defense, and the acquisition workforce took a substantial reduction as well.

What was not foreseen, and those of us who were there and those who have been there since did not adequately address, was the fact that the mission was actually still growing even though we were reducing the number of bases and so forth. So there was not an alignment of resources, skills, and capabilities to the mission. It was a kind of an across-the-board reduction.

The second thing is—and Mr. Gutridge touched on this—the workforce has never been invested in adequately, both from an acquisition perspective in acquisition skills, particularly in services, I would argue, in our field, but also in terms of technology. So how do I implement and integrate cutting-edge technologies into a Defense Department requirement? And that requires me to get other outside help to help me figure that out, because I don't have the capabilities internally.

So some of it was system, and some of it was other factors.

Mr. CONAWAY. All right.

Comments from the other witnesses?

Mr. SYLVESTER. I have a couple of comments.

On the issue of workforce, one of the problems that DOD has had over time is a continuing education process. Everyone that is in the acquisition workforce has to be certified up to a particular level that is identified with their position.

There aren't really capabilities within the Department to have continuing education as that process changes. So as we go to things like more use of commercial products or we go to things like changes in the way we manage services, there isn't a push to get people who have already been certified back in to be retrained and reeducated in those areas. And that causes some problems in the system.

The other thing I would make a comment on is the whole factor of stability. I mentioned that in my statement. One of the problems the Department has continuously is, requirements change through the life of the contract, which causes rework and causes people to have to go back and redesign things as new requirements pop up.

Now, some of that makes sense. As you learn new things, you have to do some of that. But some of it is just a factor of, we want something different now. Couple that with instability in the program budgeting process and the funding process and the yearly look at all of the programs and changing dollars, which causes a tremendous impact on costs and variability.

Mr. CONAWAY. All right.

Mr. Gutridge.

Mr. GUTRIDGE. From my opening remarks, I made a couple of points. I just want to elaborate on it.

Number one is the issue of transparency in that early dialogue prior to the presolicitation. Again, that is an area that I think we can really make some tremendous strides in. That will help us to better understand what our customer requirements are.

But the other one, I think the Defense Science Board report hit it pretty well, especially in the area of IT. It is just a long, cumbersome, difficult, challenging, complex process to buy big stuff. And so if there were some ways, especially from an IT and services perspective, to start to look at how do you do that a little differently, maybe do it more in an evolutionary approach, there

might be some benefit, in terms of reducing risk as well as speeding up the process.

Mr. CONAWAY. Okay.

Anything, Dr. Madland.

Dr. MADLAND. I think to the chairman I responded with the two main things.

Mr. CONAWAY. All right. I thank the witness, and I yield back.

Mr. ANDREWS. Thank you, Mr. Conaway.

The Chair recognizes Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

In view of the shortness of time, I would like to yield my time to Mr. Murphy.

Mr. ANDREWS. Mr. Murphy is recognized.

Mr. MURPHY. Thanks, Mr. Chairman.

Thank you, Mr. Cooper.

I want to first thank the panel of guests today but also to Congressman Andrews and the entire Defense Acquisition Reform Panel for holding this incredibly important hearing to shed light on the problems with our government procurement process. Congressman Andrews and this team have been tenacious in working to improve our acquisition system so that it provides the best for our men and women in uniform. And I truly thank all of you for that.

My question is, every year, billions of federal dollars go to companies with a history of labor and workplace safety violations. Aside from the major concern about the mistreatment of employees, it seems to me that some companies are double-dipping the taxpayer: first, obviously, the cost of the contract; but, second, for the cost of the benefits that their poorly compensated workers qualify for, such as Medicaid and food stamps. And, Dr. Madland, I wrote "one in five," according to your testimony today.

Last year, for an example, Alle Processing Corporation's employees claimed that the company used intimidation tactics, including bribery and threats of deportation, during a union organizing campaign. The company was even photographed with a banner that read, "Obama says unions are a bad deal for workers today. Save your job and vote 'no union.'" According to news accounts, workers at Alle, quote, "were paid only minimum wage, and none were given paid vacation, sick leave, or health care," end quote. In the first couple of months of 2009, Alle has already received over $350,000 in federal contracts.

In 2002, Tyson Foods were fined the maximum criminal penalty on top of a fine from OSHA after a worker was poisoned by exposure to hydrogen sulfate gas, a toxic byproduct of their facility, and yet nothing was done. The company failed to take sufficient steps to implement controls and protective equipment to reduce exposure to this gas, and their negligence led to tragedy. Just 1 year after that 2002 incident, the same, exact thing happened. A worker was exposed to this toxic gas, except this time the man died. His name was Jason Kelly. Again, Tyson Foods, they paid a fine. And despite this record, they received $1.3 billion in Department of Defense-related contracts since the 2002 tragedy.

So my question to the panel and, first, to Dr. Madland, can you quantify the cost to taxpayers of awarding contracts to contractors like these who poorly compensate and poorly treat their employees?

And how are factors such as pay, benefits, and treatment of employees currently taken into account before awarding a contract? And how can we improve the process?

I know El Paso, Texas, for example, has implemented a scoring system, weighing whether companies provide certain benefits to their employees. And are these ideas that we should consider as a panel?

Dr. MADLAND. Thank you very much for that question. I think there were two key pieces there, questions, sort of how do you quantify these costs that we were talking about in the second, and how do you reform the process.

The first, how can you or can you quantify, well there are a couple of different kinds of costs. The first kind is the cost such as Medicaid, food stamps, earned income tax credit can definitely be quantified. Studies in many states and localities have quantified these kinds of hidden costs for providing public assistance to low-wage workers. It has not been done at the federal level. Now, it would have to be an extrapolation because we do not exactly know how many federally contracted workers there are, but I think you could make some reasonable estimates and come up with a good number. In California they have done this and they estimate about $10 billion a year in state subsidies for full-time workers who earn near the minimum wage, so I think you could do something similar at the federal level.

But the kinds of costs that are much harder to capture but are real are the kinds of quality, the connection between bad workplace practices and quality. Just to give you an example of some of these kinds of relationships, there was a Department of Housing & Urban Development (HUD) audit found a direct correlation between labor law violations and poor-quality construction. New York City survey of construction contractors found that those with workplace law violations were over five times as likely to have poor performance ratings. I can list others, but those kind of costs are much harder to quantify. I think, for example, if you asked Government Accountability Office (GAO) to look at both kinds that would be a good step.

So what do we do about this? I started to talk to Chairman Andrews—you asked actually how does the government evaluate these kinds of things; does it consider labor standards? It legally could, and it occasionally does, but very often it does not.

So there are two primary ways that I think this panel could look at, and the first, as I said, was better screening for whether a company is responsible. And I think that this better screening requires two things. This is clarifying the standards—this gets to the point that Chairman Andrews was asking about—clarify the standards for evaluating whether a better—that demonstrates a satisfactory record of integrity and business ethics. For example, you know, how many violations, et cetera.

And then second, you need to create better tools to help contracting officers make this determination. The database, as we talked about, is a big first step, but it does not capture many of the important violations.

And the second key step is almost all federal contracts that are competitively bid are awarded on a best value approach in which

the government considers both price and other non-cost factors, past performance, small business subcontracting plan, technical approach, managerial capacity. We recommend that one of those non-cost factors that are used to evaluate contractors may be the pay in benefits that they provide their workers. You mentioned El Paso. That is exactly what El Paso has done for health care benefits. And they give a score for the quality of health benefits they provide, and that is one of the factors in determining whether the bidder receives the award.

Mr. ANDREWS. The gentleman's time has expired. Thank you, Mr. Murphy and Mr. Cooper.

The Chair recognizes Mr. Coffman.

Mr. COFFMAN. Thank you, Mr. Chairman.

Just a question on this insourcing. I think, Mr. Soloway, you raised it, and I think, Mr. Gutridge, you also, I think, touched on it: Where is that appropriate balance? One thing we did not hear, I think, prior to the legislation that was passed was, I think, from—we certainly heard from the public sector that there was a deficit or a lack of qualified acquisition personnel, and we needed to do more insourcing of that. But I think until today we never really heard of the consequences to the private sector. So where, in your mind, is the appropriate balance?

Mr. SOLOWAY. Mr. Coffman, I think that I would answer your question by pointing to the July 29th memorandum that the Administration issued, guidance to implement the insourcing legislation, which actually did a very good job of letting out kind of a hierarchy of how you think about federal functions and positions and the various decisions you can make associated with each.

So, very briefly, they basically get four categories. One is inherently governmental functions that we all agree absolutely have to be performed by government employees.

The second were functions of—actually positions that an organization determined were absolutely essential to its ability to control and oversee its own mission. They might not be technically inherently governmental, but it is in any organization you would want that as an in-house capability.

Then there were other fairly significant positions for which you would make a decision. You have some flexibility. Where are the greatest skills, the greatest benefits and so forth.

And then the final category, very routine functions, base-operating support services, commercial functions and so forth, where it is kind of a classic make-buy decision.

I think the issue for the Department is how do you actually do a broad strategic human capital plan that accurately captures kind of those four different pieces and looks at them in a truly strategic manner? It will vary from organization to organization. One organization may need more engineers in-house because of what they do than others, which may be able to rely more on outside engineering support, for example.

So I think it is a strategic human capital process. I think that the OMB memo that came out on July 29th actually does a pretty good job of laying out kind of the structure. It has only been 6 weeks since it came out, so it is too early to say whether it is having an effect, but even before it goes into effect, and even before

the Department of Defense has come out with its actual cost guidance internally, assumptions have already been built into the budget to the, quote, "benefit" of insourcing. I think it is kind of a "cart before the horse" situation.

One other point—I am sorry to keep coming back to this in Dr. Madland's comment—I want to remind Mr. Murphy that we would not sit here and support companies that behave in the manner in which you described some of the companies in the record that you have. But again, it is critical, as we think about the issue of benefits, and pay, and treatment of workforce, that we recognize the different standards that already exist and how they apply in different industry segments. The Service Contract Act was created to prevent precisely what you are talking about. So the 20 percent—the figure that Dr. Madland used, the 20 percent of contract workers who are getting below poverty-level wages are almost certainly not working for companies who are doing service contracts under the Service Contract Act, and if they are, there are penalties in law today that should be applied. If it is not being enforced adequately, it ought to be enforced more effectively.

The second piece is there are a lot of us in the industry who believe the Service Contract Act wages, the determinations that the Service Contract Act puts out, are woefully out of date. And so the government itself is creating a dynamic in the marketplace by saying, here is the wage you must pay, and that wage may or may not be an adequate wage in that region because it has not been updated recently enough. So I would suggest the first step here to achieve the goal I think we all share in terms of reasonable and fair treatment of workers is to focus on whether the Service Contract Act is adequately updated, modernized, and managed and administered.

Mr. GUTRIDGE. May I respond?

Mr. COFFMAN. Mr. Gutridge, did you have a comment to one of my questions?

Mr. GUTRIDGE. Yes, sir, I did. I just wanted to really underscore Mr. Soloway's comments here. Having been in the thick of this in that particular industry, dealing with that particular issue, not just recently, but really for the past six, seven, eight years, where we have literally lost dozens of people where we contracted and expanded, contracted and expanded literally in the tune of hundreds of people per year, it has caused us significant stress. And our challenge has been and the benefit to us is it causes us to create muscles that most companies our size do not have. But the challenge we had is really trying to guess what the future requirements are going to be, the lead time for going out and basically refilling the pipeline once the government has basically hired those people away from us. It takes several months. You know, when you are dealing with one or two, it is not so bad. But when you are dealing with 10, 20, 30, 40, 50, it creates a significant strain and a significant burden on a company our size, any company realistically.

So the challenge that we have is it is fine if we had a more strategic understanding of where they were trying to get to, how can we help them get there from here, develop an integrated plan that allows that to happen. And I think underscoring really trying to decide what is that sweet spot in terms of the number of these types

of critical decisions, critical skills that the organization needs for future requirements, and then how do they effectively augment those with other type, whether it be contract or other types of services and support. I think that is where the challenge always is.

Mr. COFFMAN. Thank you, Mr. Chairman.

Mr. ANDREWS. Thank you, Mr. Coffman.

The Chair recognizes Mr. Ellsworth.

Mr. ELLSWORTH. Thank You, Mr. Chairman.

Thank you, gentlemen.

I guess my question would be for Mr. Soloway or Mr. Sylvester. I have had several calls in my tenure here from vendors and manufactures in my district mainly that suggest that they have tried to break into the system, or they have looked at breaking into the system, and they know they have a better way or a product they have seen manufactured, and they can do it cheaper, better, and yet feel the system is designed to not let them break in to get into the system, or it is designed for the current vendor to keep the contract, that they have no chance. Do you see that in yours to be true? Are they just not having people in place to navigate the procurement system? That would be my first question, is it a fair and balanced competitive edge that most companies, if they want to get in, should be able to.

Mr. SOLOWAY. Mr. Ellsworth, I think it is a great question, and I think it is a question that came up when we were in your district with you and a number of your companies a year ago, some of whom were in the market and some who wanted to get into the market.

I think it is a very tough question, because the government does have, as Mr. Gutridge said, a whole set of unique requirements that make it very difficult for particularly smaller, purely commercial companies to figure out how to get in and whether they can afford to get in.

As an organization we have participated in probably a dozen seminars in various congressional districts around the country for members who are getting the very same questions from their constituents and tried to help explain to them, here are the rules of the road and kind of how you can get into this market, but it is not an easy market to get into. And a lot of it is driven by the often appropriate sort of checks and balances that are in the system, because this is a taxpayer system, not a purely commercial market, but also by some of the behaviors of the customer and the incentives that are put out in the market. So I do think it is a fair question.

I think there are ways for small companies to get into the market. Many have been creative and found a way. Mr. Gutridge's company started as a very small company, but it is a challenge, and I think that for those who are the faint of heart, it may not be the best market in the world, because the government does put very heavy burdens on all of its companies that are doing business. Even if we could argue whether we need more or less in certain areas, the basic requirements to get into the system are not simple.

Mr. ELLSWORTH. Thank you.

Mr. Sylvester, let me change the subject a little bit. We talked about—let us just call them change orders for the sake of that. Cer-

tainly the safety of our troops is paramount, and if they need something done to fix a weapon or fix something that keeps them safer, a vest or helmet, how much—discuss a little bit about what might go on. Someone sees a better idea, an idea comes from the field, a manufacturer sees something. Oh, let us change this strap from this to this, wouldn't that be better if it were an inch wider, and then can manipulate the system. Let us change this, charge more, redesign. And do we get taken advantage of that way in companies changing up orders on equipment, on small and maybe insignificant and nonuseful changes, that they could then bill back the government?

Mr. SYLVESTER. While I am sure that happens from time to time, I do not think, at least from my experience, that is really prevalent where we have companies who are making those small incremental changes and then saying, here we have this idea, and we are going to charge the government for this. What I see more is companies that have ideas about things and go talk to the requirements drafters and say, we can do these kinds of things if you will change the requirements to allow us to do that. In some cases those particular requirements have been demonstrated, and in some cases they have not. And so the people who are in the requirements process would look at that and make changes in the contracts. There is a place for that to have that done.

But again, going back to this idea of stability, once we beginning a manufacturing process, except for things that are safety related or those kinds of things, we need some stability in that process, which goes back to the evolutionary acquisition idea. If we can have a system that is truly evolutionary, we can begin to take those new ideas and introduce them into the system and get them into the requirements that way, in a logical way that doesn't impact our manufacturing capability.

Mr. ELLSWORTH. Mr. Gutridge, you shook your head in the affirmative. I assume you agree with that, or do you have a comment?

Mr. GUTRIDGE. Putting my previous life's hat on where I dealt with this issue on a daily basis with aviation, engineering change proposals were always a struggle. When you are buying unique items, when you are buying a lot of them, you know, we consider those things very carefully. But we control the process because they were basically producing something for us.

When we get into the commercial marketplace, it changes the paradigm entirely, because all of a sudden now producers are looking at, well, I have got this great big marketplace over here, and I have got this smaller niche market over there, and if I did this thing, well, it has this direct benefit to my bottom line because it increases my sales or whatever.

So part of the challenge that we always struggle with when we get into buying commercial products is that there is the recognition and understanding that a bit you give up that control over that configuration of that end item. And that is a business decision that the Department makes on a regular basis. And part of it has do with how long are we going to use it; what is the total life-cycle cost. And these are all considerations that are taken into account in that acquisition process.

Mr. ELLSWORTH. Mr. Chairman, I do not know how much time I have left, but if I could yield the balance of my time to Mr. Murphy. He had another question.

Mr. ANDREWS. Absolutely. Mr. Murphy is recognized.

Mr. MURPHY. Thank you, Mr. Chairman.

Thank you, Mr. Ellsworth.

Mr. Soloway, I know you mentioned about the Service Contract Act. Do you have any comments? And if Dr. Madland could comment.

Mr. SOLOWAY. I just wanted to make the point that I think that the ethic of what Dr. Madland is talking about is something we could all sign up to, and we actually talked briefly earlier about sitting down and trying to figure some of this out.

But I think the issues that Mr. Andrews referenced earlier about where you draw the line here, and what kind of guidance and objective criteria you are going to provide to government contracting officers to make what could be some really complicated decisions about relative severity of relative kinds of violations of different laws, the truth is without in any way defending a company that is a scofflaw, some of the companies that are referenced in the record and so forth, many companies have some kind of violation somewhere inadvertently committed, and how you start making those decisions I think is an enormously complex issue.

Mr. MURPHY. May Dr. Madland comment on that?

Mr. SOLOWAY. Yes, but one last point. The second point I want to make is we do not, in fact, in government contracting make these best-value trade-offs the majority of time. In fact, the majority of government contracts are awarded on a low-bid basis. Best-value contracting is actually the exception, not the rule. Now, we have advocated if you use more, I think you sometimes get what you pay for, if you will. And using all these other factors in a source-selection decision makes sense, but the vast majority of government contracts are either a sealed bid, which is just they simply look at the cost, or what we call low-priced technically acceptable, which is not a cost trade-off process.

So I think that the ethic of what Dr. Madland is proposing is something we can all sign up to. I think that the Service Contract Act is a leveler. It is designed to try to avoid these kinds of issues.

Mr. MURPHY. Dr. Madland, my time——

Mr. ANDREWS. Well, actually Mr. Murphy, you are entitled to be recognized for five minutes on your own time. So you are recognized for five minutes.

Mr. MURPHY. Thank you.

Dr. Madland.

Dr. MADLAND. Thank you.

There were three big issues that I wanted to hit on: Talk about the Service Contract Act, how you sort of quantify the standards for whether a company is responsible, and then this idea of best value.

The service contract, other prevailing wage laws like the Service Contract Act and Davis-Bacon are very important in assuring that standards aren't driven down, but they are not very effective at raising standards. Just to give you a couple of examples of what the actual prevailing wages are right now, $8.17 for a janitor in

Houston, $9.49 for a security guard in Tucson, $7.25 for a fast food worker in Chicago, without benefits. That includes the total package. And these were just updated a couple months ago.

So these prevailing wage laws are important to ensure that standards are not driven down totally to the bottom, but they are not—not sufficient.

The second idea was sort of how you develop the standard for evaluating whether a company is responsible, how many labor law violations, et cetera. This is a very important and difficult question to answer, but I want to emphasize that many, many states have been doing this for years. California, Massachusetts, tons of local governments have developed quantified systems where they evaluate, okay, this many standards is this many violations is this many points, and you need to have this many points to be determined responsible. So it is a determination that, while difficult, it is something that other procurement systems regularly do.

And then the last idea, my point was about low-cost technically acceptable—Mr. Soloway claims that I think he was saying we—the government procurement only evaluates most bids based on cost. Well, in the low-cost technically acceptable, they do look at non-cost factors; it is just whether a minimal threshold is met. Most competitively bid contracts include those low-cost technically acceptable or the more fully negotiated process where there is actual trade-offs between cost and non-cost factors.

Mr. MURPHY. Do you want to comment, Mr. Soloway?

Mr. SOLOWAY. This is going to be a long discussion, and I said that in all due respect. I would just point out that, again, the threshold issue is a critical issue. In California I believe if you have four violations of the Davis-Bacon Act, you get zero points on their scoring system. But if I have thousands and thousands of workers, I could have four violations fairly quickly. Whether that is the right or the wrong standard is another issue, but I think that is a really important point.

The last point I will make about the Service Contract Act, Davis-Bacon, and the other prevailing wage laws that exist, whether they were designed do to do this or not, they have, in fact, become a floor; they are a minimum. The idea of a prevailing wage is supposed to be the prevailing wage. What is the appropriate wage for work in a given district or a given region of the country, and on top of that you then have to pay a certain given health and welfare benefit.

So perhaps the discussion should begin with are the prevailing wage laws, in fact, getting us to prevailing rates or to the floor that Dr. Madland was talking about. That is a policy decision for the Congress and the Administration to make. From an industry perspective, as long as the Congress and the Administration recognize whatever all of the implications are for driving wages, whatever level the Congress and Administration decide is appropriate, that is a different discussion. From an industry perspective it is a relatively level field. We are all going to be bidding to the same rules, if you will. But there is a difference between the minimum and a prevailing wage, so the question perhaps is whether the Service Contract Act is prevailing or setting just a floor.

Mr. MURPHY. I want to go back to the metrics. You know, we talked about the database earlier. To give an example, 2008, Propper International, the largest manufacturer of uniforms for the United States military, settled a case with the National Labor Relations Board after employees charge that the company did not grant legally required paid sick days or vacation days, and the company violated labor laws by threatening employees who were trying to organize. So according to the press account about this company, Defense Logistics Agency (DLA), which had awarded the contract, offered that, going forward, it would take labor law violations into account when it reviewed contractors' performance using a national database that tracks these violations.

So my question to the panel, and I will start with Dr. Madland, can you describe to us how the database is currently utilized by procurement officials and if consulting the data is generally voluntary as it would seem based on the Propper International case? And what do we need to do to maximize its potential and encourage or require potentially officers to consult prior to awarding a contract?

Dr. MADLAND. Thank you.

Your question is correct. The database is just being created. It is supposed to be created by October of this year. And the proposed rules state that contracting officers shall consider all the information in the database, which seems like a pretty strong standard. So that seems like a good thing. And I am not sure how much further you could go, although you should be aware that even like in the debarment category where they must look at it, oftentimes contract officers still don't, and GAO has done studies and found that.

And so this database is going to be a big, big improvement, but as I mentioned before, the standards of exactly how it is applied are not quite clear, and it will miss many labor law violations. In addition, it does not capture private-sector compliance, so we are missing half the story or more. It is not publicly available.

Now, a step is I think defense authorization this year, I think that is correct, will allow Members of Congress to look at it. It also, as I said, does not capture settlements without acknowledgement of fault, and the minimum threshold for fines is often below the level.

Now, you mentioned the case of Propper International. They are the largest military uniform manufacturer, and some of their violations would probably be captured by this database, and there would be a record on which to judge them. So they had 152—157 health and safety violations over the past 20 years; 58 of those categorized as serious violations, or death, or serious physical harm could have resulted to workers. The more recent ones probably would be captured.

Mr. ANDREWS. I just want to ask if Mr. Soloway would want to comment, because the gentleman's time is expired. Thank you, Dr. Madland.

Mr. SOLOWAY. I will just go back to the point Dr. Madland touched on. The issue here is how we set the standards. I think there is going to be—it is a very complicated question. The database is a reality, it is happening. How we set the standards, they give guidance to the workforce. Number one, the database should

never be made public because there is a lot of sensitive proprietary information subject to all kinds of misinterpretation.

How we guide the workforce in terms of how you make a decision, what is a pattern of abuse versus individual instances. A company could have had three or four years of abuses and then completely thrown out all of their management, changed their business practices and processes, and said, hey, this is now a good company. How an institution responds to problems is not an unimportant issue.

So I think all of the issues—and the question of how we actually guide the workforce towards making reasoned, fair, transparent decisions. Companies are going to have access to their own records, so they can see what is in there. But they will have no access to information as to why they were determined to be responsive or not, which is essentially debarment. If you are not responsible, you cannot bid. You have been effectively barred from the process. So I think this is a very, very complicated issue.

The last point I will make is I would hope Congress would not go back and revisit the question of whether we should include settlements on which there were no findings. From a perspective of law, if I settle a case with you, and I do not admit guilt, and you do not admit that I was innocent, that is why we have settlements. And that is a very dangerous road to go down to presume that somebody is guilty because they settled a case. As I think we all know there are a lot of settlements in which you do it for other reasons. So I think the standards issue is the critical question.

Mr. ANDREWS. We thank you, Mr. Murphy, and thank the members of the panel. As is generally the case, well briefed and prepared witnesses generate more questions than they answer, which is good. I mean that as a compliment.

I think what the panel will take away this morning is that in this process of creating the right environment for a vibrant and stable set of industrial bases, as Mr. Soloway points out, we need to do a number of things. From Mr. Soloway we heard that although multiple-award task order contracts have a certain value, we need to be sure that they do not add more costs than they generate benefit, that we carefully evaluate the use of those vehicles and others.

Mr. Sylvester, certainly we do need to look at the overall capital-raising environment in which his members are operating. They are not just competing against other defense companies, they are competing against tech companies and financial services companies, a lot of other people.

Mr. Gutridge, one lesson I think we learned from you is that we do not want to wall ourselves off from the benefit of the commercial global marketplace because of requirements that are superfluous or unnecessary. I think we all agree that security requirements, quality requirements are non-negotiable. But we may be precluding ourselves from some excellent bidders because we are having the tail wag the dog.

And finally, Dr. Madland, I think your efforts and Mr. Murphy's efforts really do point out that the strongest value for the people in uniform and for the taxpayer comes from a fair workplace relationship, and where that workplace relationship is unfair or miss-

ing, that is a deficiency in the whole process that we need to refocus on.

So I appreciate the witnesses and my friends here on the panel. The committee will continue to explore these issues. Essentially our work plan, which I discussed with—which we discussed with the minority staff, is to continue a series of hearings where we explore hypotheses about the reasons for this gap between price and value for the balance of the calendar year. The panel will then convene in the first quarter of 2010, and the Members will discuss among ourselves recommendations that we will then want to make to our colleagues in the full committee with a report that we hope will be the basis for legislative action in next year's defense authorization bill.

So again, we thank the witnesses for their time and thank our colleagues. The hearing stands adjourned.

[Whereupon, at 9:25 a.m., the panel was adjourned.]

A P P E N D I X

SEPTEMBER 17, 2009

PREPARED STATEMENTS SUBMITTED FOR THE RECORD

SEPTEMBER 17, 2009

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TESTIMONY OF

STAN SOLOWAY

PRESIDENT & CEO
PROFESSIONAL SERVICES COUNCIL

BEFORE THE
DEFENSE ACQUISITION REFORM PANEL

COMMITTEE ON ARMED SERVICE

U.S. HOUSE OF REPRESENTATIVES

SEPTEMBER 17, 2009

Introduction

Chairman Andrews, members of the Defense Acquisition Reform Panel, thank you for the opportunity to be here with you today. My name is Stan Soloway and I am the President and CEO of the Professional Services Council. 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. More than two-thirds of our member companies provide a wide range of support to the Department of Defense. Approximately two-thirds of our members are also small businesses. Together, the association's members employ hundreds of thousands of Americans in all fifty states.

I want to thank you for taking the time to hold this hearing. In any business environment, it is essential that the customer have a deep and current understanding of the supplier base upon which it relies. That understanding is a key component in the development of business practices and policies which serve the best interests of the customer, enable robust partnerships, and optimize competition, performance, and efficiency.

The defense department has long recognized the importance of understanding and working closely with its traditional industrial base—the companies that develop and manufacture the weapons systems and equipment that is so essential to our national security. This recognition is demonstrated by the presence of an office of industrial affairs within the office of the secretary whose main focus is the hardware industrial base. That office helps assess current industry dynamics, the competitive landscape, the effects of proposed mergers or acquisitions, and more. Given the vital role played by the defense systems industry, and the monopsony environment in which it largely functions, continued and careful attention to industrial base issues is appropriate and essential.

At the same time, even as the department seeks to improve its oversight of services contracts, we believe it also needs to increase its insight into and understanding of the supplier base performing on those contracts. In 2008, the department spent over $180 billion on services, more than 40 percent of the department's total contract spending. Although there is overlap between the services and hardware industrial bases, they have very different compositions and dynamics. But it is only in very recent years that the department has begun, on a very limited basis, to assess the services industrial base. Consequently, the department's insight into and understanding of the services sector remains very limited and we are concerned that these limitations are driving or defaulting to business practices and policies that might not be in the department's long-term best interests.

In our view there are two key elements to assess the industrial base: first, its structure and dynamics, and second, the way in which the customer's actions, in this case the government's actions, impact that structure for better or for worse. As such, I have divided my testimony today into two parts: the first is a review of what we know about the services industrial base and the second focuses on the ways in which some current government actions are impacting it.

The Services Industrial Base

Until very recently, there had been no meaningful efforts in either the government or industry to assess the state and principal dynamics of the federal services industry. In 2006, the Center for Strategic and International Studies (CSIS), with the strong support of PSC, undertook the first comprehensive analysis of this type, focusing primarily on six key categories of services which combined account for the vast majority of federal spending on services contracts.

Drawing on data from the defense department and the Federal Procurement Data System (FPDS), CSIS found that the services sector includes tens of thousands of companies, but that only a small portion, perhaps as low as 20 percent, actually derived more than modest revenues from government services contracts. Further, CSIS found that the vast majority of those companies providing services to the federal government are either small or what we refer to as "mid-tier" firms. In fact, only slightly over 100 companies actually derived more than $1 billion in contract dollars from the federal government during the period from 1995 to 2004. The study also clarified what many had come to believe in recent years: the services sector has become increasingly horizontally integrated across both different services segments—IT, professional services, logistics, etc.—and across the hardware and services segments. In other words, the study documented the increasing role in services by the traditional, large systems integrators—a dynamic that is consistent with a larger trend in our economy, as well as the government, in which customers increasingly seek total solutions and capabilities. Moreover, the government's expanding and increasingly complex missions, coupled with its now well-known skills gaps, have also led to a greater reliance by the government on professional services firms in particular, where so many of those skills reside today.

The CSIS study was updated in 2008 and again confirmed that the federal services sector is robust and highly competitive. In fact, in their latest analysis, CSIS found that fully 70 percent of all professional services contracts were awarded competitively—which, in the CSIS analysis, means the government actually received two or more bids. Finally, the study also documented the dramatic rise in multiple award, task order contracts, which require firms to compete twice for government contracts—once to get on the contract vehicle and again to win individual task orders through which actual work is awarded. According to CSIS, through 2008, nearly 70 percent of all service contract dollars were awarded through these types of vehicles.

There is far more information and context contained in the full CSIS study, but the key takeaways, particularly as they relate to this hearing, are as follows:

- the services sector is diverse and competitive.
- the rapid growth of large, multiple award, contracts has increased both the transactional costs and competitive pressures in the market, particularly, but not solely, for small and mid-tier firms for whom such investments are especially taxing.
- the services sector is both more diverse and more competitive than the hardware sector, even though most, if not all, hardware providers are also key players in the services space.

To its credit, the defense department, specifically the office of industrial affairs, has used the CSIS reports as a baseline for their further study and analysis. However, to date, beyond that initial work, the department's investment in and focus on the sector has been very limited. Nonetheless, the department continues to promulgate new processes and rules regarding services acquisitions. We suggest that these efforts, important as they are, should be informed in advance by meaningful industrial base analyses so that their impacts are fully understood and appreciated before being implemented. These analyses may also benefit Congress as it considers enacting legislation affecting services.

Assessing the Current Policy Framework

Even though the government does not invest much time or resources in assessing the services industrial base, or in training its acquisition professionals on the dynamics or key characteristics of that base, including how to acquire services, there are nonetheless some broad frameworks which drive a range of policies that directly impact the sector. As the CSIS study demonstrated, the services sector is very diverse; over 95 percent of all companies participating at any meaningful level have revenues below $1 billion, and the vast majority of those firms have revenues below $100 million. As such, the critical core of the services sector really does consist of small and mid-tier firms. And therein lies the first and most significant area of challenge. For firms in that range, the most pressing issue facing them is their ability to grow and succeed.

This problem is principally driven by a longstanding binary presumption in government contracting that firms are either small or other than small. Yet, as the CSIS study demonstrated, there is substantially more diversity in the sector and multiple layers of firms within each size category. In other words, the traditional binary foundation of our federal government contracting policies fails to recognize the diversity that characterizes the industry, particularly for services.

Second, there is growing concern among both small businesses and small mid-tier businesses as to whether the foundation of the government's small business programs and policies are the right foundation. There is a fundamental question that needs to be asked: is the purpose of our federal small business program to create small businesses, or to create sustainable small businesses that can grow and succeed to the limits of their ability and ambition? For the most part, current small business policies are geared toward the former objective and the program is relatively successful on that front.

Indeed, while significant and appropriate attention is paid to requiring substantial small business participation in federal procurements—a policy we strongly support—there are numerous opportunities in which innovative acquisition strategies could be employed that ensure or at least enable both robust small business and mid-tier business participation. But from a longer-term perspective, and given the critical role small business plays in our economy, it does seem that our national economic interest, and the interests of the government which benefits from a thriving competitive marketplace composed of companies able to build truly sustainable capabilities, would be better served if equal emphasis was placed on removing barriers to growth and sustainability.

For small businesses, while concern always exists about the availability of work, there is a growing concern, particularly among innovative, entrepreneurial firms, about their sustainability after they graduate from the small business program. For mid-tier firms who are too small to compete for huge, integrated requirements but too large to compete for small business opportunities, the challenges are similarly acute.

This is not an issue unique to the defense department nor is it an issue DoD can itself fully address. But there are things that can and should be done to begin to balance our focus to ensure that the industrial base is as competitive and robust as it can be. It is time for the Small Business Administration to, among other things, move forward with a thoughtful and evidence-based rewrite of the small business size standards, which have not been updated in nearly two decades and are sorely out of date. It is time to return to the separate size standard for federal procurement. As the Congress reviews and continues to address small business policies, the fundamental question about the purpose of federal small business programs must also take a far more prominent place in the discussion.

In major weapons systems acquisitions, it is routine to conduct an industrial base assessment of an acquisition strategy with the intent of ensuring that the strategy will not adversely affect the long-term competitiveness and viability of that base; such analyses should become routine for large services procurements. Doing so could well lead to innovative source selection strategies that open doors of opportunity to companies of all sizes in cases where those opportunities might otherwise be limited.

Workforce Development

And then there is the issue of workforce development. Under the Defense Acquisition Workforce Improvement Act, defense department acquisition professionals are required to undergo specific training in order to be certified for certain levels of work in contracting, program management and more. Unfortunately, while the department, principally through the Defense Acquisition University (DAU), has made progress in recent years in modernizing its training for services acquisitions, there is much critical work still to be done.

As an example, several years ago, DAU asked PSC to review its curriculum for services contracting to identify possible gaps. We did so and identified a major gap—nowhere did the curriculum include training on business risk identification and mitigation, which is the core of any business relationship. If you don't understand the risks being faced by your suppliers and how they have to mitigate those risks, a balanced and effective business relationship will be hard to achieve. At DAU's request, we developed a module covering this essential topic. Unfortunately, the course in which it is included is offered only sporadically and is not required. And to our knowledge, the essential components of that module are not taught anywhere else in the school's curriculum or continuous learning initiatives. As such, too many DoD acquisition professionals still lack adequate awareness and knowledge of their services supplier base. As DoD seeks to rebuild and realign its acquisition workforce and skills base, and as services continue to command such a significant portion of DoD's contract dollars, this type of workforce development is essential.

The Current Policy Environment

Perhaps the most important area for your consideration today is how current policy initiatives are, or could be, negatively impacting the services industrial base and the spirit and ethic of partnership that is so important. While virtually every policy initiative has the potential for impacting the industrial base and, indeed, any policymaking process should take such factors into consideration, I will focus today on three key issues: insourcing, organizational conflicts of interest, and fixed price contracting.

Insourcing

No issue in federal acquisition has commanded as much recent attention as that of insourcing and attention to the issue must increase even more. While this is not a hearing on insourcing, the issue has significant effects on the industrial base and on DoD's relationships with the services industry.

Today in DoD, there are essentially three streams of insourcing activity: insourcing that is in response to Secretary Gates' initiative to rebuild critical elements of the DoD workforce, particularly in acquisition; insourcing that is in response to legislative direction that all agencies consider insourcing a range of currently contracted work; and insourcing that is connected to budgetary targets. In each of these three streams, real concerns are emerging.

We have been very supportive of Secretary Gates' workforce initiative; let me reiterate the actions we recommended to the secretary in our April letter. The initiative must be strategic, it must focus on the truly critical skills the department clearly needs in order to control and manage its missions, and it must be conducted in a manner that is fair to both federal employees and contractor employees alike. In fact, our recommendations are entirely consistent with report language this committee included in the FY 2010 defense authorization bill and with the July 29 guidance issued by the Office of Management and Budget. We recognize the department's need to ensure it has adequate and appropriate skills in place and, for the most part, do not question the goals the secretary has set out to address those challenges. But while his initiative is not yet in full swing, there are some troubling early signs.

First, while OMB clearly delineated in its July 29 policy guidance the differences between inherently governmental functions and critical skills positions, there is concern that a number of DoD components are applying far too broad a brush. In so doing, they appear to be seeking to insource work that is entirely appropriate for contractor performance, and, as a consequence, may well be driving up the cost to the government of performing that work.

The implications of this broad brush approach are many, but from an industrial base perspective, it creates enormous business risk and uncertainty. As the OMB guidance makes clear, there are essentially four levels of work in government: inherently governmental functions which must be performed by government employees; mission critical skills, some of which clearly need to be retained by the government in order to effectively control and manage missions, but the remainder of which can be subjected to a rigorous "make or buy" analysis; and routine functions for which the decision to insource or outsource involves the same basic questions of best value

and performance. Unfortunately, today, there is little evidence that components are making their sourcing or workforce planning decisions consistent with that guidance.

In addition to determining what positions or activities to consider for insourcing, the OMB guidance makes clear that the insourcing consideration required by the law is NOT an insourcing mandate. Further, OMB does an excellent job of setting forth the key decision parameters and options available to agencies as they seek to comply with the law. Key among those elements are ensuring that the total cost to the taxpayer is considered in the decision process and recognizing that for work currently under contract, and which is appropriate for contractor performance, recompeting the contract is both an appropriate and important option to drive cost savings. After all, everywhere else in federal procurement the rule of the day is competition, competition, and competition. Why would we want government entities, which are currently supported by competitively awarded contracted services, to eliminate competition from the mix and replace it with a sole source, non-competitive monopoly? Of course, the guidance is still new and it is unreasonable to think its impact will have already been widely implemented. But the early results are not promising.

Moreover, the implementation of the statutory requirements has a direct relationship to the budget-driven adjustments now being made throughout the department. The defense department has issued guidance to the field on implementation of the statute, but, as we have communicated to Deputy Secretary Lynn, that guidance needs to be strengthened to ensure real discipline goes into the decision process. Unless and until the issue of true, total cost and value is assessed in a real and analytically defensible manner, the department is at significant risk of making decisions that will actually drive up long-term costs—an outcome I hope we can all agree is neither preferable nor sustainable.

Unfortunately, mythology is becoming accepted as "fact" that contractors are more expensive than federal employees performing the same work. While that assumption is based on demonstrably faulty analyses, the defense department actually makes a declarative statement to that effect in its budget guidance. As a result, the military services have established budgetary reduction targets tied to a specific number of positions to be insourced, and are assuming savings of thirty to forty percent through their insourcing activities.

The problem is that these figures are meaningless. As has become an unfortunate custom around government, alleged cost comparisons between contractors and federal employees involve comparing the total, billed cost of a contractor to only the immediate salary and benefits of a federal employee. In such a comparison, clearly the federal employee will always be less expensive. However, it is an apples to oranges comparison, since no one accounts for all of the costs associated with performance by a federal employee, particularly the overhead that is attendant to any and every federal employee. After all, just as is true in the private sector, the government has real overhead costs that must be paid, such as personnel office staff and systems; pay office staff and systems; travel systems; workforce training and development; laptops and cell phones; infrastructure maintenance; and, of course, lifetime benefits. When all of these costs are factored in, it is clear that the thirty percent savings assumed by some will never occur. There may be apparent "savings" at the local base or activity level, since their budgets do not account for most of these overhead costs. But they are nonetheless very real costs to the government and

are paid directly by the taxpayer. And when one adds to the analysis the fact that the profit component of most federal services contracts is only a small portion of the total billed cost, and that agencies are routinely offering contractor employees sometimes significant pay increases to convert to government employment, the supposed savings might well turn into significant cost increases.

OMB touched on this important point in its July guidance and Congress, given its responsibility for funding and oversight of federal agencies, should demand rigorous and complete cost assessments. Particularly in this era of budgetary strain, it is counterintuitive that any of us would want any government agency to spend unnecessarily or excessively, be it on a contract or on internal personnel.

The challenges to the industrial base are exacerbated further by the growing trend of government entities, particularly but not only within DoD, directly soliciting contractor employees to convert to government performance. We recognize that some in government have long been concerned about contractors soliciting their employees only to bill them directly back to their old agency at a higher cost. While it is not clear that such practices are as common as some might think, it is clear that they are not appropriate whether undertaken by contractors or by the government. In fact, agencies such as the National Reconnaissance Office prohibit contractors from engaging in such poaching activities.

Today, our companies report the most aggressive and extensive efforts by the government to hire their employees that they have ever seen. In a recent survey of PSC member companies, more than half said they were facing these challenges. We know that at least one Navy command has a list of hundreds of contractor employees it is directly soliciting, or plans to solicit, to convert to the government and we know of individual cases in other segments of the department where similar activities are underway, often involving heavy handed techniques that border on unethical.

Further, in many cases, that recruiting is accompanied by offers of significant signing bonuses, pay raises, and other incentives, and the impacts are widely underestimated. From the perspective of the services industrial base, current trends suggest that the government does not recognize the full impacts of its actions.

Such behavior is anathema in the private sector. Companies routinely enter into non-solicitation agreements to build trust, protect important information, avoid interfering with employer/employee relations, and build partnership. After all, such balance is a key to the dynamics of the industrial base and the business relationships that define it.

I would add that this behavior also raises real questions about the government's adherence to the merit systems hiring process which we believe is increasingly being either ignored or effectively circumvented. That is one reason the Director of the Missile Defense Agency in June issued a directive prohibiting the direct solicitation of the agency's contractor. These issues were also the focus of a recent letter from members of the full House Armed Services Committee to the Secretary of Defense and are touched on in report language this committee adopted in the FY 2010 defense authorization bill.

No one can or should limit the free movement of people, or the robust competition for talent; however, where there is a direct business relationship, such solicitation, in either direction, should be firmly prohibited. Therefore, this IS an industrial base issue since it strikes at the heart of the government's relationship with its services providers, increases costs and risks for the contractor, and could actually incentivize the wrong types of behavior by both the government and its contractors. Likewise, arbitrary or quota-driven insourcing has a highly negative effect not only on the best interests of the taxpayer, but also on the industrial base and the partnerships that are so essential to the functioning of government. Such actions dramatically increase risk and uncertainty for the industrial base, inhibit the ability of companies to offer the kind of solutions the government seeks, raise costs, and more. I would urge this panel to address this issue immediately and directly.

Organizational Conflicts of Interest

Another area of significant concern for the services industrial base is that of organizational conflicts of interest (OCI). As the services industrial base has become more horizontally integrated, concerns about the government's ability to manage or mitigate potential conflicts of interest have grown as well. For example, the Government Accountability Office has issued a series of bid protest decisions challenging the degree to which the government was adequately identifying or managing such conflicts. The FY 2009 defense authorization act requires DoD to develop new policy and guidance on conflicts of interest. The Federal Acquisition Regulations (FAR) Council is in the process of developing new policy in this important area and, in response to the 2009 Weapons Systems Acquisition Reform Act, the defense department's Contracting Integrity Panel is charged with conducting an analysis.

This is an issue with clear implications for the services industrial base. We recognize that the changes that have taken place within industry have made the conflict of interest challenges more complex. But as we have recommended to the FAR Council, we need to avoid broad, one-size-fits-all prescriptions and agencies must be clear from the very start of each and every procurement about the kinds of conflicts that concern them and the parameters that they are going to establish. Today, we have a plethora of disparate policies and strategies across and even within individual components. This issue does affect large, systems integrators and is also a significant issue for small and mid-tier firms. We are seeing agencies like the Missile Defense Agency establish a very rigid conflict of interest policy where the greatest impacts are on smaller firms. Too much rigidity in this area could well lead to a range of unintended and costly impacts.

As DoD and the FAR Council continue their work on this important issue, we have urged them to make sure they have fully assessed and weighed the relative impacts of differing policy prescriptions on the competitiveness and vitality of the services industrial base, with particular attention to small and mid-tier firms.

Fixed Price Contracting

Finally, there is the issue of fixed price contracting. In recent years, tremendous pressure has been placed on government acquisition professionals to utilize fixed price contracts. In his

guidance on executing stimulus act contracts, OMB Director Orszag states that such contracts are the best means by which to protect the government's interests. And indeed, on one level, since such contracts appear to shift all of the risk to the contractor, that could be true. But in many cases, it really isn't.

Almost any company presented with a business opportunity in which the requirements and performance outcomes are clearly defined, and the risks involved in execution are manageable, would greatly prefer a fixed price contract. And indeed, the vast majority of government contracts are awarded on a fixed price basis. But when the requirements are vague or uncertain, or when the performance measurements are inconsistent or unclear, and/or the technical risks are substantial, a fixed price contract presents unsupportable risk to the buying agency and to the companies bidding. Although some believe that, by definition, cost type contracts are counter to the interests of the government, the truth is that in appropriate circumstances cost type contracts reduce the government's risks and enable the government to most effectively manage and control both cost and performance. The key word, however, is manage. The focus of our attention should be the extent to which the government manages its cost type contracts. Simply shifting to a fixed price environment places inordinate risk on the contractor and, almost certainly, drives costs higher for the government because the contractor must build its pricing to protect against risks. Further, imposing fixed price contracts in the wrong circumstances raises significant challenges to optimum performance.

From a services industrial base perspective, this is a challenge for all companies, but again, one with even greater challenges for small and mid-tier firms who face greater challenges to stay competitive in a robustly competitive market, and for whom margins of error or risk are far smaller. Moreover, the current trend of defaulting to fixed price contracts, even when the conditions I mentioned above are not present, is again a reflection of the government's limited understanding of the fundamentals of business risk and risk management in the services sector. Here again, the July 29 OMB policy guidance provides a helpful and neutral framework with regard to choosing the appropriate contract type. That framework must now be implemented across the government, in a fully transparent and accountable manner, so that contracting officers can again feel they have the flexibility and authority to select the contract type that best meets the government's needs in each individual situation.

Conclusion

Mr. Chairman, there are any number of challenges facing the services industrial base today and in my testimony I have outlined just a few. We believe that the problems we now face stem primarily from the fact that it is only in recent years that DoD, or the civilian agencies, have begun to focus on services as an industry unto itself. Where appropriate, it is important to separate the issues and challenges affecting the hardware and services sectors, and to build the kind of knowledge base and insight among the government acquisition community that is necessary to engaging in business relationships that serve the government's and the taxpayer's best interests. Thank you again for taking the lead in holding today's hearing. We look forward to working with you on these and many other related issues in the future.

PSC PROFESSIONAL SERVICES COUNCIL

STAN Z. SOLOWAY

Stan Z. Soloway is President and CEO of the Professional Services Council, the principal national trade association of the government professional and technical services industry. PSC is widely known for its leadership on the full range of government acquisition/procurement and outsourcing and privatization issues. Soloway assumed the presidency in January 2001. PSC has a membership of over 330 companies of all sizes, performing services of all kinds for virtually every agency of the government.

In addition to serving as President of PSC, Soloway was confirmed by the Senate in June 2007 as a member of the Board of Directors of the Corporation for National and Community Service. He writes a monthly column in *Washington Technology* magazine and was a member of the congressionally mandated, national panel on the future of government outsourcing chaired by the Comptroller General of the U.S. Soloway is also a Principal of the Partnership for Public Service, where he also serves as a charter member of the Council's "Senior Advisors to Government Executives" program and as a mentor to mid-career civil servants in the Partnership's Annenberg Leadership Fellows Program. He is a member of the Executive Advisory Board of the National Contract Management Association, and received the prestigious Federal 100 Award in 2005.

Prior to joining PSC, Mr. Soloway served as the deputy undersecretary of defense (acquisition reform) and concurrently as director of Secretary of Defense William Cohen's Defense Reform Initiative. As deputy undersecretary, he was the department's senior official responsible for the development and implementation of far-reaching reforms to DoD's acquisition processes and policies and for the oversight of the training, education and career development of the 200,000-member defense acquisition workforce. As director, DRI, Mr. Soloway led significant department-wide re-engineering and reform initiatives in areas as diverse as privatization and outsourcing, electronic commerce, financial management reform, logistics transformation, and the quality of life for American troops.

In recognition of his leadership at DoD, Mr. Soloway was awarded both the Secretary of Defense Medal for Outstanding Public Service and the Secretary of Defense Medal for Distinguished Public Service.

Before his appointment to DoD, Mr. Soloway was a public policy and public affairs consultant for more than 20 years and a highly regarded expert on acquisition, privatization, and outsourcing issues. He also co-produced the critically acclaimed "Great Confrontations at the Oxford Union", a series of prime-time specials that aired nationally on public television. He earned a degree in political science from Denison University, where he was elected to the National Men's Journalism, National Men's Leadership, and National Political Science honorary societies.

DISCLOSURE FORM FOR WITNESSES
CONCERNING FEDERAL CONTRACT AND GRANT INFORMATION

INSTRUCTION TO WITNESSES: Rule 11, clause 2(g)(4), of the Rules of the U.S. House of Representatives for the 111th Congress requires nongovernmental witnesses appearing before House committees to include in their written statements a curriculum vitae and a disclosure of the amount and source of any federal contracts or grants (including subcontracts and subgrants) received during the current and two previous fiscal years either by the witness or by an entity represented by the witness. This form is intended to assist witnesses appearing before the House Armed Services Committee in complying with the House rule.

Witness name: Stan Soloway

Capacity in which appearing: (check one)

___Individual

_X_Representative

If appearing in a representative capacity, name of the company, association or other entity being represented: Professional Services Council

FISCAL YEAR 2009

federal grant(s) / contracts	federal agency	dollar value	subject(s) of contract or grant
None			

FISCAL YEAR 2008

federal grant(s) / contracts	federal agency	dollar value	subject(s) of contract or grant
None			

FISCAL YEAR 2007

Federal grant(s) / contracts	federal agency	dollar value	subject(s) of contract or grant
None			

Federal Contract Information: If you or the entity you represent before the Committee on Armed Services has contracts (including subcontracts) with the federal government, please provide the following information:

Number of contracts (including subcontracts) with the federal government:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

Federal agencies with which federal contracts are held:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

List of subjects of federal contract(s) (for example, ship construction, aircraft parts manufacturing, software design, force structure consultant, architecture & engineering services, etc.):

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

Aggregate dollar value of federal contracts held:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

Federal Grant Information: If you or the entity you represent before the Committee on Armed Services has grants (including subgrants) with the federal government, please provide the following information:

Number of grants (including subgrants) with the federal government:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

Federal agencies with which federal grants are held:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

List of subjects of federal grants(s) (for example, materials research, sociological study, software design, etc.):

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

Aggregate dollar value of federal grants held:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

STATEMENT TO THE PANEL ON DEFENSE ACQUISITION REFORM

SEPTEMBER 17, 2009

Richard Sylvester
Vice President, Acquisition Policy
Aerospace Industries Association

The Defense acquisition system is complex with a large body of laws, regulations, policies, and procedures. As the Business Executives for National Security (BENS) noted in their report, "Getting to Best: Reforming the Defense Acquisition Enterprise," July 2009, defense acquisition revolves around 15-year programs, 5-year plans, 3-year management, 2-year Congresses, 18-month technologies, 1-year budgets, and thousands of pages of regulations. There has been substantial expansion of acquisition-related legislation in the national defense authorization acts passed during the past 10 years. Since the late 1990s, the number of acquisition provisions put in place by Congress has increased by three-to-four fold. In the past two years alone, the number has approached 100.

At the same time, there has been growth in the defense budget along with a dramatic reduction in the acquisition workforce-making it almost impossible for acquisition officials to perform their jobs efficiently and in compliance with all rules and laws. Moreover, there is a commensurate cost of compliance on the part of the defense industry included in the prices of goods and services.

The Aerospace Industries Association (AIA) believes that now is the time to recalculate the imbalances in the defense acquisition system and take action for positive reform to ensure that the policies and processes that govern it are fair, reasonable and flexible.

AIA appreciates the work that this Panel and Congress as a whole has done by enacting the Weapons System Acquisition Reform Act of 2009, (Pub. L. 111-023). That Act included provisions that addressed several issues of concern to industry – the need for well-defined requirements, the establishment of stable procurement plans, realistic cost estimating and budgeting, and the creation of a well-trained and experienced acquisition workforce. However, there is more to be done.

PROMOTE STABILITY AND FAIRNESS IN CONTRACTING AND FINANCIAL POLICY

Fair acquisition policies are needed to maintain a competitive defense acquisition environment for the Government and a healthy defense and aerospace industrial base. In order to maintain a competitive industrial base that effectively supports the warfighter and the nation, the Government should develop policies that reinforce the supportive role that contractors provide the Government as well as promote contracting and financial policies that encourage and reward good performance, promote fairness and stability, and establish balanced and equitable risk-management relationships.

To achieve this goal, AIA proposes a series of reforms related to 1) commercial item reform, 2) financial and contractual policy reforms, and 3) workforce stability and fairness in contracting and financial policy.

Commercial Item Reform

The U.S. Government acquires goods and services to support the enormous variety of missions of agencies ranging from the Departments of Defense and Homeland Security, the Veterans Administration, the Federal Aviation Administration, and the General Services Administration. Most of these goods and services are not unique to Government needs but can meet Government requirements with only minor modifications. They are readily available from commercial companies, and buying them commercially provides significant savings of time and money and often the very best available capability.

Congress recognized the opportunities commercial items provided to the Government and that procurement statutes were not well-suited to acquiring these items from commercial companies. As a result, it enacted several statutes beginning in 1994 to help the federal acquisition system more readily incorporate commercial items whenever and wherever practicable to meet the Government's needs:

- The Federal Acquisition Streamlining Act (FASA) (P. L. 355, 103rd Congress, 2nd Session, 1994).
- The Federal Acquisition Reform Act (FARA) of 1996, Division D; National Defense Authorization Act for FY 1996, (P. L. 106, 104th Congress, 2nd Session, 1996).
- The Services Acquisition Reform Act of 2003 (SARA) (P. L. 136, 108th Congress, 2nd Session, 2004).

Passage of this legislation was a recognition that policies were written to address the Government's unique needs and that more streamlined policies were necessary to draw commercial companies into the Government supply base and to take full advantage of the commercial marketplace. Commercial companies that do a relatively small percentage of their business with the federal Government find it very difficult to meet Government-unique procurement policies and practices while still competing globally and responding to competitive pressures.

The benefits of employing commercial item acquisition processes are many and widely recognized. The DoD Inspector General's office identified the benefits of commercial acquisition in its audit report D-2006-115, Commercial Contracting for the Acquisition of Defense Systems, September 29, 2006. The report lists the importance and benefits of commercial item acquisition to DoD, including:

- Access to state-of-the-art technology and products.
- Savings on limited financial resources for research and development.
- Establishment of a market price as a price analysis tool.

- Integration of the defense and commercial industrial bases to benefit the nation's security and economy.
- Reduced economic risk associated with developing new items.
- More rapid deployment of state-of-the-art technologies and terms.
- Access to proven technological capabilities.
- Increased competition.

While complex products, such as weapon systems, frequently take a decade or more to field, technologies from the commercial marketplace can be rapidly applied and fielded. This is particularly the case in the electronics industry whereupon much of the defense and aerospace industry depends. Acquiring existing commercial technologies enables DoD to maintain the technological superiority necessary to address new challenges. Because the United States needs rapid, unimpeded access to these commercial technologies, it must be able to quickly and simply purchase commercial and other state-of-the-art products and technology from commercial suppliers.

Considerable progress in adapting the acquisition process to the commercial marketplace was made in the first decade after these statutes were enacted and implemented. In more recent years, however, there has been a disturbing retreat when acquiring commercial items toward the use of Government-unique procedures and intrusive Government oversight more appropriate to products where the U.S. Government is the only buyer. Commercial companies have become concerned that excessively unique, costly and burdensome requirements will reemerge and lead to the Government's inability to access the best commercial technology.

The availability of commercial, item-appropriate acquisition procedures in Federal Acquisition Regulation (FAR) Part 12 has enabled the Government to obtain high-technology products. When using FAR Part 12, the Government receives state-of-the-art technology without the delays attendant to its own development process and at a market-tested price that compensates producers for their own investments, the costs of which are spread over a considerably larger customer base.

Commercial acquisition policies have attracted commercial companies and given DoD and other agencies the benefit of shorter time spans to field capabilities and logistics support using commercial distribution systems and increased competition. Recent changes in policies and legislation, however, require commercial item suppliers and manufacturers to establish a Government-unique business infrastructure with increased requirements for cost and pricing data and disclosure of business-sensitive information -- constraints unparalleled in the commercial marketplace and exposing commercial companies to increased risk.

Should current trends continue, we risk significantly limiting the ability of the Government to access cutting-edge commercial technologies. If manufacturers are forced to segregate production of commercial and Government items -- where a single

commercial production line is now in use -- and establish a Government-unique cost accounting system, the costs could be prohibitive for the Government. Commercial companies cannot afford to jeopardize their survival in intense, globally competitive marketplaces by taking on the burden of compliance with procurement policies more appropriate to Government-unique procurements. Like "requirements creep" in a development program, "regulatory creep" in the form of a growing list of Government-unique clauses that can be imposed on FAR Part 12 procurements has a negative effect on the desired outcome. Too many Government-unique requirements that are being added to commercial item acquisitions will again chase commercial companies from the Government marketplace.

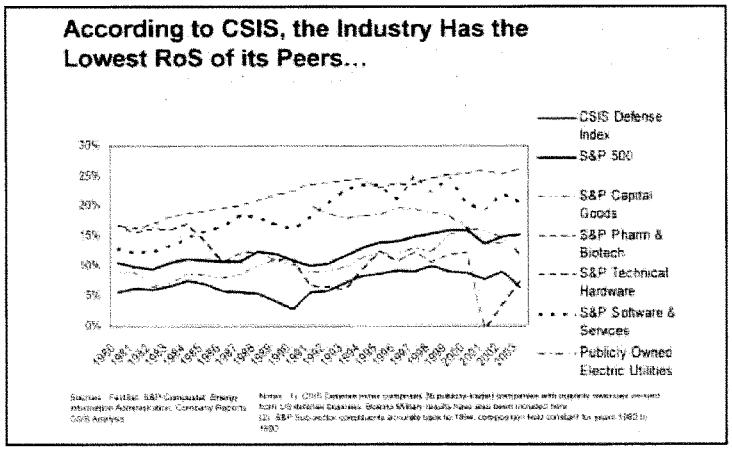
AIA is concerned that there has been a steady erosion of the streamlined approach to commercial item acquisition — an approach that adopted an appropriate and carefully crafted balance between commercial item acquisition and more detailed procedures for acquiring Government-unique goods and services. These unique requirements will force commercial companies to decide whether their business with the U.S. Government has become too difficult, risky and costly to continue. This will hurt the U.S. Government both by increasing costs enormously and by depriving it of what in many cases is the latest technology. Therefore, AIA supports industry-wide efforts to preserve the flexibility needed for commercial item acquisition.

Financial and Contractual Policy Reform

The aerospace and defense industry is considered a relatively volatile market with comparatively low returns, given the high levels of risk. Returns are sometimes lower than the cost of capital, with the lowest returns historically on large development contracts. Additionally, most, but not all, major aerospace and defense contractors are largely dependent on U.S. Government sales and foreign military sales for sustaining and expanding their business bases. Hence, the Government must recognize its responsibilities as a monopsonist procurer because there simply is no alternative domestic market for most of the aerospace and defense systems it buys. And, because many of today's large development programs are not followed by long, predictable and profitable production runs, development contracts must be capable of generating reasonable returns, independent of any projected production.

The following 20-year review of the defense and aerospace industry's margins, developed by the Center for Strategic and International Studies (CSIS) (Figure1), indicates that the industry historically has been among the lowest sectors in return on sales (ROS).

FIGURE 1



DoD incentive policies must reward good performance and enable contractors to earn a fair return on research and development contracts. With fair returns for good performance, companies are more likely to invest in independent R&D and make capital expenditures. Unstable Government financial policies will impede industry's ability to earn fair returns.

Some recent Government policy changes impacting industry's ability to earn fair returns include:

- Reducing contract incentives and award fees.
- Renegotiating prices to adjust for excessive pass-through charges consisting of normal overhead.
- Preventing the net cost impact of simultaneous contractor cost accounting changes.
- Disallowing costs for pension contributions required by law.

The following actions would assist in stabilizing DoD financial policies and controlling cost growth:

1. Appropriate Contract Type. The Presidential Memorandum on Government Contracting issued on March 4, 2009 states, with respect to contract type, "there shall be a preference for fixed-price type contracts; cost-reimbursement contracts shall be used only when circumstances do not allow the agency to define its requirements sufficiently to allow for a fixed-price type contract." These policy statements are consistent with the long-standing preference in the Federal Acquisition Regulation (FAR) for fixed-price type contracts (note FAR 16.301-2, "cost-reimbursement contracts

are suitable for use only when uncertainties involved in contract performance do not permit costs to be established with sufficient accuracy to permit any kind of fixed-price contract"). However, AIA is concerned that the pendulum may be swinging

Past experience has demonstrated that the very nature of advanced development is risky. Selection of the appropriate contract type in development can also do much to limit delays to the warfighter and cost growth on major weapons systems programs. Misalignment of contract type and performance risk often results not only in delays but also leads to disputes, cost overruns and failures that further damage the credibility of the procurement process. Fixed-price contracts are suitable for acquiring supplies when there is a stable design based on validated requirements and specifications so that the Government and the contractor can establish reasonable prices early on. A fixed-price contract, however, is generally not suitable for high risk, such as the development of major weapon systems with ambitious performance requirements. Cost-reimbursable contracts are more appropriate in those instances. AIA urges caution in the application of fixed-price contracting for development contracts unless this contract type can be closely tied to what could reasonably be considered a low level of technological risk in the proposed development program. Fixed-price contracting is most appropriate in the context of mature production programs. This most likely would be the case with those programs being considered for multiyear contracts.

Some in the acquisition community believe that fixed-price development contracts improve cost credibility. They do not. Use of fixed-price development for major systems drove companies close to bankruptcy and deprived programs of the contract flexibility to deal with normal research and development risks, such as the need for redesign or retesting. When contractors lose substantial amounts of money performing defense contracts, the Department of Defense is harmed as well. Program managers are prevented from managing these programs effectively because time must be spent arguing over small and frequent changes and claims as contractors try to obtain additional money to permit continued program performance.

AIA concurs with the long-standing preference for fixed-price contracts in Government contracting. However, it is critical that contracting officers retain the flexibility to select the appropriate contract type based on factors including the complexity of the requirement, the maturity of the technology, and the stability of the design. Therefore, AIA urges the Administration and Congress to encourage the use of contract types that are appropriate to the circumstances of the acquisition. In particular, the initial development phase of a program should be accomplished on a cost-type contract and only when risk has been appropriately reduced if the program transitions to a fixed-price contract.

2. Incentive Fee Reforms. The U.S. aerospace and defense industry must be able to earn a fair and reasonable profit in the defense marketplace in order to attract capital and skilled employees and provide competitive returns to investors. Government policies should reward good industry performance and offer industry the opportunity for

fair and reasonable margins and cash flow in the performance of Government contracts. Important reforms in the area of incentive fees include providing fair opportunities to secure reasonable returns by moving toward objective incentives; permitting rollover of the unearned incentive fee-pool into subsequent opportunities to earn the incentive; funding and awarding cost-reimbursable development contracts at the Government's estimate; and increasing the emphasis on cost realism in source selections.

3. **Award Fees.** Where award fees are still appropriate, the Administration and Congress can take several actions. These actions include promoting reasonable and flexible implementation of the April 24, 2007, memorandum *Proper Use of Award Fee Contracts and Award Fee Provisions* from the Director of Defense Procurement and Acquisition Policy (DPAP). Industry will assist in the dialogue with DPAP on implementation issues, including implications for industry pricing policies.; providing base fees and higher available award fees; permitting award fee rollover in appropriate circumstances; encouraging use of provisional award fee payments to enhance cash flow; and encouraging alignment of award fee pool payments with overall program expenditure levels.

4. **Ethics/Disclosure.** It is the policy of all aerospace and defense companies to conduct business affairs fairly, impartially, and in an ethical and proper manner. The highest possible standards of ethical and business conduct are expected. The Government should consider industry comments on proposed changes to the Contractor Code of Business Ethics and Conduct rule regarding mandatory reporting of ethics violations of federal law to the inspector general rather than voluntary disclosure. Consideration should be given to the negative effect of mandatory reporting and the positive benefit of voluntary reporting. The development of new ethics rules should include consideration of investigative time and probable cause. Company management should have opportunities to remedy contracting problems or negotiate rectification with contracting officers, thus avoiding immediate, mandatory disclosures to the DoD Inspector General of any violation of Government rules.

5. Intellectual Property. New Government rules designed to aid sustainment of Government systems could discourage private investment in technology innovation and create a barrier to commercial technologies by requiring commercial contractors to justify proprietary data rights to privately developed intellectual property as a condition of doing business.

Obtaining greater rights in data alone will not solve most logistics support problems. Excessive Government demands for data in requests for proposal are counterproductive. A policy priority should protect the private sector's intellectual property rights, especially those necessary to encourage private investment and innovation.

6. Sensitive but Unclassified Information. The Government should work to ensure a workable approach to preventing inappropriate access to unclassified sensitive

information. In particular, draft Government rules on protecting unclassified information on contractor networks do not define clearly the information to be protected, threaten to disseminate network vulnerabilities, do not consider the costs of developing systems to protect such information and are unclear in the penalties for failure to protect such information.

The Government information assurance implementation group should take account of the industry position on protecting sensitive unclassified information and work toward a single memorandum of understanding for companies to sign on voluntary disclosure of inappropriate network incursions.

Workforce Stability and the Role of Federal Contractors

A significant challenge for the Government is addressing the loss of talent and expertise in its defense acquisition workforce. This decade-long development has led to an increasing dependence on contractors for key acquisition functions. A smaller and much weaker defense acquisition workforce can ultimately impair both necessary Government oversight and the timely acquisition of military capabilities by DoD.

Successful defense program management requires a professional federal workforce with expertise in the subject area. Since the early 1990s there has been a conscious national effort to reduce the size of the federal workforce, and the Final Report of the Defense Acquisition Performance Assessment (DAPA) Panel, January 2006, determined that the reduction brought with it a corresponding reduction in the size of the Government acquisition workforce. Personnel losses have been significant and the workforce is understaffed and overworked. As a result, the Government workforce has become "increasingly overburdened as the demands have increased with the nature and complexity of the acquisition system."

As DAPA noted:

- No single organization is accountable for acquisition workforce career development; gaps in leadership and management continuity contribute to a lack of direction and leadership in the acquisition workforce.
- DoD acquisition personnel responsible for requirements, budget and acquisition do not have sufficient experience, tenure and training to meet current challenges; personnel stability is not sufficient to maintain adequate understanding of programs and program issues.
- Importantly, system engineering capability within DoD is insufficient in many areas, such as development of joint architectures and interfaces, definition of interdependencies of program activities and management of large scale integration efforts. Core competencies gravitate to the private sector as the Government is deemed less a desirable employer.

Rebuilding the Government acquisition workforce and stabilizing its leadership will take time. This should be measured in years, not months. Legislation mandating transition of functions outsourced to the private sector back to the Government with a specific time period might not only be unrealistic but also counterproductive to the Government's current set of needs and requirements. Against this backdrop of workforce challenges, the Government is at severe risk of losing additional technical expertise if acquisition and systems engineering expertise is mandated to be brought back "in-house."

It is important that decisions to in-source functions be based on a sound business case analysis. Industry is concerned that, rather than performing the analysis to make the best decision for the Department and the taxpayer, an arbitrary goal will be established to in-source a set number of positions. For example, according to an internal working memo, the Navy alone proposes to in-source approximately 9800 jobs over the next 6 years and assumes that the government can perform the work for 60% of the industry cost. While the memo does not go into any level of detail regarding how 40% savings can be achieved, we are concerned that they will do so by hiring fewer people or hiring personnel with more limited experience. Alternatively, if the personnel savings are not achieved, the accompanying budget reductions will result in cuts to system development.

PROMOTE REFORM OF MAJOR ELEMENTS OF THE ACQUISITION SYSTEM

Defense acquisition reform has become an omnipresent issue -- each new Administration arriving in Washington works to propose reforms to streamline a system that is seen as too large, too bureaucratic, too cumbersome and too slow in getting needed goods and services to our warfighters. Government policies should foster the development and support of innovative and affordable products and services that continually adapt and remain relevant to an ever-changing global security environment.

AIA is prepared to work with the Administration and Congress in a positive way to address these challenges and make the acquisition system more transparent and accountable. But industry also knows that a key to achieving long-lasting reforms is an in-depth understanding of not only those reforms that the Government must make but also the factors that drive industry decision making. Integrating industry considerations into the process is critical to ensuring that both Government and industry achieve their acquisition objectives.

An important element in this effort will be development of a cooperative and positive working relationship with the Department of Department. While the DoD-industry relationship has improved recently, we believe that this partnership can be strengthened further through increased personal contact with DoD leadership.

A sound Government-industry relationship is vital to our nation's future -- industry stands ready to serve and support in any way we can. Reestablishing regular meetings among the Secretary or Deputy Secretary and aerospace and defense CEOs would do

much to facilitate better communication and dialogue.

Budget/Program/Requirements Stability and Logistics Reform

AIA recommends that the Government move to stabilize program requirements, budgets and system configuration -- arguably the largest contributors to program cost growth, schedule delay, and performance challenges. Many former high-level DoD acquisition officials have noted that the requirements and budget process "is broken," and yet it is the most critical part of the acquisition process because validated requirements and baseline budgets are the foundation from which future growth and performance are measured.

1. Budget Stability. Multiyear budgeting and support for funding strategies, such as advance appropriations and capital investment funds, should be considered because they would introduce additional stability into the defense acquisition system. Unfunded mandates should not be levied on existing programs. Alternatively, unfunded mandates, such as recent statutory requirements regarding pension funding, should be legislated as allowable costs and considered as below-the-line adjustments that have no impact on a program's cost baseline. Annual inflation/escalation requirements should be appropriately estimated and fully funded. Program budgets should be based on realistic estimates that reflect no lower than an 80 percent probability for success. Require the Defense Department to budget programs at no lower than an 80 percent probability of success. Where justifiable, management reserves should be funded and fenced. Industry should be able to take full advantage of current DFARS guidelines that allow added profit for cost efficiency and technology/manufacturing incentives.

2. Program Stability. DoD should increase investment in maturing technologies in order to reduce program risk. Each Service Acquisition Executive should have direct control of a capital fund (notionally several percent of the Service's procurement topline) to address emergent and unanticipated program challenges.

3. Requirements Stability. Requirements need to be clearly defined and stabilized before the design and development of systems and platforms. Cost and schedule should be better integrated into the requirements process. Requirements changes after a program baseline is established should be fully funded by the respective military service before implementation by the acquisition agent as a configuration change to the system or platform. There also will be a greater need to think in terms of subsystems of systems and open architecture to accommodate the needs of multiservice and multinational customers.

4. Logistics Reform. In order to achieve additional savings, DoD should aggressively reform its logistics and sustainment function to improve readiness, enhance warfighter support and address the major force modernization and recapitalization needs that the United States faces today. Logistics reforms will ensure measurable improvements in

systems performance and maximum efficiency in resource allocation to meet this national defense imperative. Performance improvements will be evidenced in enhanced availability, reliability and maintainability of DoD assets.

To achieve improved performance and resource allocation efficiency, the department must:

- Transform product support to a performance-based model across all DoD platforms.
- Rapidly expand commercial supply chains for commercial commodities.
- Right-size and modernize DoD mobility capabilities.
- Increase reliance on commercially provided in-theater logistics support.
- Implement modern logistics information systems through a managed service model.
- Modernize force training.

An integrated logistics reform agenda from the new administration that addresses the six areas above will help strengthen the force modernization program our nation needs for the 21st century.

Multiyear Procurement Authority Reform

At the national level, AIA has spoken to the need for increased resources for our country's defense modernization effort (see AIA's report, "U.S. Defense Modernization: Readiness Now and For the Future, April 2008"). It is becoming increasingly apparent in the aftermath of our extended presence in Iraq that the reset and recapitalization requirements are large and across-the-board and the list of unfunded service procurement requirements continues to grow every year. In addition, the Services are faced with extensive modernization and recapitalization bills caused by deferred post-Cold War investment spending. There currently is a growing requirement throughout the defense establishment for modernization and recapitalization of defense equipment -- some have estimated the bill to be as high as $100 billion.

In this emerging defense environment, multiyear contracting authority offers DoD and the defense industrial base an important tool for addressing broad and continuing defense acquisition requirements. As noted by the RAND Corporation, "such contracts afford contractors the opportunity to buy materials in more economical quantities, schedule workers and facilities efficiently, and reduce the burden of preparing multiple proposals. The U.S. Government also benefits from a reduced workload.".

There are also strong and compelling programmatic arguments for expanding

multiyear and block-buy contracting authority. Multiyear procurement authority is an integral element of a broader defense-wide effort to achieve greater program and funding stability. Expanded use of multiyear authority will enable the Government to achieve maximum savings on individual programs and retain the flexibility it needs to reinvest the accrued savings intelligently on other defense activities, including defense procurement.

If planned and managed properly, multiyear procurements can be especially important tools in helping baseline and stabilize defense budgets and programs. In addition, properly structured multiyear contracts can provide increased incentives for design stability and technological maturity in our weapons procurement process. Multiyear contracts can also be of importance in such areas as energy, reduction of critical readiness shortfalls and performance-based logistics.

A House proposal considered during the fiscal 2008 National Defense Authorization Act would have provided new authority for the secretary of a military department to enter into a multiyear procurement provided the contract addressed a critical readiness requirement as designated by the new Defense Readiness Production Board (DRPB).

For example, the authority would have applied to procurements that had previous multiyear contracts, such as those that have been in full-rate production for three years or were non-developmental commercial items. DoD supported the House proposal, but in choosing to stand up the DRPB, Congress did not provide the multiyear authority for critical readiness items. This is an area AIA believes deserves reconsideration by the next administration and the next Congress.

One additional area in which multiyear authority should be considered for expansion is performance-based logistics (PBL) where DoD contracts for supplies or support over a period of time and not on a level of effort. Shorter-term contracts limit the contractor's ability to make necessary trade-offs to meet or exceed PBL threshold performance outcomes. Yet, objective evidence has clearly established cost savings averaging 20 percent relative to organic support through longer-term PBL contracts.

Nunn-McCurdy Reform

Section 802 of the Fiscal Year 2006 National Defense Authorization Act significantly changed the Nunn-McCurdy Act (10 USC 2433) governing reporting of major defense acquisition program (MDAP) cost breaches. The new requirements replaced the two previous categories of cost growth with four new thresholds that would trigger congressional notifications.

MDAP cost-reporting requirements were extended to include reports on cost growth above both current and original program baselines with a subdivision of cost growth into "significant" and "critical" categories. This revision increased the number of thresholds for Nunn-McCurdy breaches from two to four. Significant breaches have an

increase of 15 percent over a program's current baseline or 30 percent over its original baseline. Critical breaches involve an increase of 25 percent over a program's current baseline or 50 percent over its original baseline.

The Fiscal Year 2006 update applied to MDAPs for which an original baseline estimate is established on or before the date of enactment. An exception was made, however, for MDAPs already having exceeded their original baseline by more than 50 percent. For these programs the current baseline for the program at the date of enactment was deemed its original baseline.

Congress addressed changes to the Nunn-McCurdy reporting requirements in the Weapons System Acquisition Reform Act of 2009. However, cost growth documented by the SAR process often occurs for several valid reasons aside from program performance, such as quantity, mission, and scheduling adjustments. AIA believes that DoD should be allowed to reset the baselines for programs that have exceeded their program acquisition unit costs/procurement unit costs by 50 percent when MDAPs experience mid-program quantity reductions or budget cuts as directed by Congress or the Department , experience fact-of-life increases (i.e., commodity prices, foreign currency fluctuations), or an individual program's scope to expand in the development phase due to configuration changes to accommodate validated emergent mission requirements without that counting against the cost baseline of the original program.

PROMOTE THE COMPETITIVENESS AND EFFICIENCY OF THE AEROSPACE AND DEFENSE INDUSTRY

The benefits of globalization in the defense market are critical to both U.S. security and the U.S. aerospace and defense industry. Globalization helps the U.S. achieve its overarching national security strategy objectives while also enhancing the competitiveness and vitality of U.S. aerospace and defense exporters.

AIA has been at the forefront of national efforts to support U.S. defense trade and modernize our nation's export control system. Technology trade and cooperation play a central role in support of the aerospace industry's 645,600 jobs. Aerospace companies posted a $61 billion surplus in 2006 even while the U.S. trade deficit was nearly $800 billion. Such efforts are essential to build greater interoperability and defense cooperation between the United States and its friends and allies.

In addition to supporting reforms in the areas of defense trade and export control, AIA advocates reforms to America's tax, financial, and industrial base policies. Reforms in these areas will strengthen the economy, ensure DoD access to the best sources in the global supplier base and make the United States more competitive in the global defense marketplace.

Advocate Tax and Financial Reforms to Strengthen America's Economy and Global Competitiveness

AIA strongly recommends the repeal of the arbitrary 3 percent tax withholding on every Government payment to contractors. The new withholding penalizes tax-paying contractors, especially smaller companies whose financing costs are higher. Just to administer the law, DoD's costs will be $17 billion, not considering the inevitable price increases that will result from contractors' recoupment of their costs.

CONCLUSION

Government and industry need to return to basics. The requirements for our national security have not changed – the threats from many sources remain along with the need to modernize, recapitalize, and reset our equipment. In order to maintain a competitive industrial base that effectively supports the warfighter and the nation, the government must promote balanced, stable, and fair contracting and financial policies that offer the opportunity for reasonable returns and cash flow in the industry's performance of government contracts. Industry acknowledges that such reforms should be based on good performance. In today's resource-strapped environment, industry takes its role to be a responsible acquisition partner seriously.

Biography

RICHARD K. SYLVESTER

Vice President, Acquisition Policy
Aerospace Industries Association

Richard Sylvester joined the Aerospace Industries Association in August of 2009. Heading AIA's Procurement and Finance division, he is responsible for directing the development and coordination of the Association's positions on proposed procurement-related legislation, regulations, and their implementation.

Sylvester served in the Defense Department in a number of capacities for 35 years prior to joining AIA, most recently as deputy director of Acquisition Resources and Analysis (Acquisition Management) in the Office of the Undersecretary of Defense for Acquisition. He was responsible for the development of acquisition strategies, program baselines and acquisition decision memoranda.

While deputy director of acquisition resources and analysis (Acquisition Management) Sylvester led a Joint Analysis Team of nine senior government analysts and three contractor representatives in developing recommendations to improve the efficiency of acquisition program decision forums. Working with the Undersecretary of Defense for the Comptroller and the military departments, Sylvester also created the first financial reporting baseline for DoD's military equipment.

Sylvester graduated from the University of Michigan with a bachelor of arts in political science and economics.

Sylvester began his career in defense acquisition with the U.S. Army Materiel Command and later served in an array of increasingly responsible positions in the Pentagon, including deputy director for defense procurement and acquisition policy (Acquisition Workforce and Career Management) and deputy director for acquisition resources and analysis (Property and Equipment Policy). Sylvester served a year as a legislative fellow working for Senator Carl Levin (D-MI).

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DISCLOSURE FORM FOR WITNESSES
CONCERNING FEDERAL CONTRACT AND GRANT INFORMATION

INSTRUCTION TO WITNESSES: Rule 11, clause 2(g)(4), of the Rules of the U.S. House of Representatives for the 111th Congress requires nongovernmental witnesses appearing before House committees to include in their written statements a curriculum vitae and a disclosure of the amount and source of any federal contracts or grants (including subcontracts and subgrants) received during the current and two previous fiscal years either by the witness or by an entity represented by the witness. This form is intended to assist witnesses appearing before the House Armed Services Committee in complying with the House rule.

Witness name: Richard Sylvester

Capacity in which appearing: (check one)

___Individual

_X__Representative

If appearing in a representative capacity, name of the company, association or other entity being represented: Aerospace Industries Association

FISCAL YEAR 2009

federal grant(s) / contracts	federal agency	dollar value	subject(s) of contract or grant
BLS 9-001M	Dept of Labor	$369,000	Cost Index Survey

FISCAL YEAR 2008

federal grant(s) / contracts	federal agency	dollar value	subject(s) of contract or grant
BLS 8-001	Dept of Labor	$353,000	Cost Index Survey

FISCAL YEAR 2007

Federal grant(s) / contracts	federal agency	dollar value	subject(s) of contract or grant
BLS 7-003	Dept of Labor	$346, 000	Cost Index Survey
BLS 7-003D			
Supp Agreement	Dept of Labor	$8,000	Additional Info on Survey

Federal Contract Information: If you or the entity you represent before the Committee on Armed Services has contracts (including subcontracts) with the federal government, please provide the following information:

Number of contracts (including subcontracts) with the federal government:

Current fiscal year (2009):_____ 1_____;
Fiscal year 2008:_____1_____;
Fiscal year 2007:_____1_____.

Federal agencies with which federal contracts are held:

Current fiscal year (2009):_____DoL_____;
Fiscal year 2008:_____DoL_____;
Fiscal year 2007:_____DoL_____.

List of subjects of federal contract(s) (for example, ship construction, aircraft parts manufacturing, software design, force structure consultant, architecture & engineering services, etc.):

Current fiscal year (2009):____Cost Index Survey_____;
Fiscal year 2008:_____ Cost Index Survey_____;
Fiscal year 2007:_____ Cost Index Survey_____.

Aggregate dollar value of federal contracts held:

Current fiscal year (2009):_____$369,000_____;
Fiscal year 2008:_____$353,000_____;
Fiscal year 2007:_____ $346,000_+ $8,000_____.

Federal Grant Information: If you or the entity you represent before the Committee on Armed Services has grants (including subgrants) with the federal government, please provide the following information:

Number of grants (including subgrants) with the federal government:

Current fiscal year (2009):_____0_____;
Fiscal year 2008:_____0_____;
Fiscal year 2007:_____0_____.

Federal agencies with which federal grants are held:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

List of subjects of federal grants(s) (for example, materials research, sociological study, software design, etc.):

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

Aggregate dollar value of federal grants held:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

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Oral Testimony – Robin "Pug" Gutridge
on
The Department of Defense and Industry: Does DoD Effectively Manage its Industrial Base and Match its Acquisition Strategies to the Marketplace?

Good morning, Chairman Andrews and Ranking Member Conaway, my name is Pug Gutridge and I am President of Cherokee Information Services. I am a retired U.S. Coast Guard acquisition professional and pilot, and have spent the last 13 years in the private sector. Cherokee is an IT services provider to the Department of Defense (DoD) and other civilian agencies, and I am honored to be here today to represent TechAmerica[1] and provide you with our thoughts on the acquisition of technology at DoD.

The most important point I want to make to you today is that the Department of Defense – and the rest of the U.S. Government for that matter – has moved away from the tenets Congress adopted in the last 10-15 years to make acquisition of commercial and COTS items easier and more affordable. Now agencies are moving toward an environment that is increasingly government-unique in both the requirements placed on the products and services being acquired, and in the terms and conditions under which the acquisition can occur. If we continue down this path, the Government will find it increasingly difficult to attract and retain commercial IT and technology providers, and, subsequently, to unearth and utilize the kinds of innovation we see in the commercial market today.

One of the main reasons for this is because the DoD role in the global IT marketplace is diminishing, which leads to decreased competition. Currently, DoD accounts for less that .1%, so incorporating the government-unique requirements I mentioned previously will only make it more difficult for a company to enter the DoD market or sustain a presence.

[1] TechAmerica is the leading voice for the U.S. technology industry, which is the driving force behind productivity growth and jobs creation in the United States and the foundation of the global innovation economy. Representing approximately 1,500 member companies of all sizes from the public and commercial sectors of the economy, it is the industry's largest advocacy organization and is dedicated to helping members' top and bottom lines. It is also the technology industry's only grassroots-to-global advocacy network, with offices in state capitals around the United States, Washington, D.C., Europe (Brussels) and Asia (Beijing). TechAmerica was formed by the merger of AeA (formerly the American Electronics Association), the Cyber Security Industry Alliance (CSIA), the Information Technology Association of America (ITAA) and the Government Electronics & Information Association (GEIA). Learn more at www.techamerica.org.

Another reason is because DoD acquisition of technology takes significantly longer than the commercial product lifecycle, and is vastly different from the commercial buying process. Because technology refreshes at a minimum of every 18-24 months, a commercial acquisition best practice is to identify the products and/or services, buy them, and deploy them in less than 24 months. This time frame is feasible because market research, due diligence, and pre-solicitation processes are much more open to dialogue and establishing trusted relationships than the federal acquisition process.

The current buying practices of the Department also disguise its presence in the commercial marketplace. Although DoD spends a considerable amount of its budget on IT, the average contract action size has reduced from nearly $2.5M in 2000 to $204K in 2007. So this fragmented buying practice, coupled with the increased risk for commercial companies and the rising cost of winning and sustaining contracts, has diminished the attractiveness of the DoD market.

We also have significant concerns that the erosion of the acquisition workforce is making DoD less able to keep pace and deploy innovative solutions. We have seen an increasing ratio of contract transaction numbers and size to the number of employees, but we have also seen a significant decline in the numbers of that workforce who have the adequate skills to understand complex information systems. Attracting the best and brightest workforce is crucial to the development of adequate requirements, which leads to the creation of effective technology systems and enterprise-wide solutions.

The last point I wanted to note is that the increasingly risk-adverse environment under which we are currently contracting only leads to decisions by government personnel based largely on avoiding risk. We believe that acquisition practices should be aligned to reward actions to acquire IT services or products in a timely, cost-effective manner. We must find a way back to a more open environment that creates incentives and rewards for the acquisition workforce and the contracting community to produce outcomes based upon best value for the Warfighter and the taxpayer.

Thank you again for the opportunity to provide our perspective on the Department of Defense and industry, and we hope that you find our particular perspective on the technology and IT sector informative to your efforts on the Panel. I would be happy to answer your questions.

Mr. Robin "Pug" Gutridge

As President of Cherokee Information Services Robin "Pug" Gutridge oversees a highly successful Information Technology and Management Services Company that supports the Government and private sector.

Mr. Gutridge came to Cherokee in 1998 after a successful career in the United States Coast Guard, where he graduated from the US Coast Guard Academy and served as a Helicopter Pilot, Engineer, and Acquisition Professional.

In addition to his responsibilities as President, Mr. Gutridge provides technical and consulting services to a number of Federal Government customers on a variety of topics. Projects range from representing the US Government in a variety of national and international working groups, to working with Department for Defense (DoD) in developing a new methodology to reduce risk and improve interoperability of their information systems. Mr. Gutridge has been active in making better use of Information Technology in a variety of other sectors including: Health, Logistics, Enterprise Management, and Emergency Management and Response

Mr. Gutridge is also active in various organizations such as the US Chamber of Commerce, TechAmerica, and the Association for Corporate Growth. In these organizations he serves on a number of committees all related to improving the manner in which business is conducted and services are provided.

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Witness name: Robin E. Gutridge

Capacity in which appearing: (check one)

___ Individual

X Representative

If appearing in a representative capacity, name of the company, association or other entity being represented: Tech America

FISCAL YEAR 2009

Federal Grant(s)/Contracts	Federal Agency	Dollar Value	Subject(s) of Contract or Grant
HDTRA1-04-C-0009	Defense Threat Reduction Agency, DoD	$3,720,000	IT Services
GS-06F-0173Z	Office of Surface Mining, DOI	$300,000	IT Services
1406-04-06-CT-39670	Office of Surface Mining, DOI	$90,000	IT Services
GS-00F-0052M	USMC, DoD	$300,000	Logistics Services
GS-00F-0052M	Defense Supply Center Philadelphia, DLA, DoD	$3,578,096	Acquisition Support
GS-00F-0052M	Defense Supply Center Columbus, DLA, DoD	$7,200,000	Acquisition Support
SP0103-04-D-0008	Defense Logistics Agency, DoD	$120,000	Analytical Support
GS-00F-0052M	USMC, DoD	$300,000	Logistics Services
NRC-10-06-401	Nuclear Regulatory Commission, DOE	$161,500	Administrative Support
GS-00F-0052M	USMC, DoD	$842,261	Logistics Services
DTFAWA-03-D-03018	BITS II FAA	$45,000	Acquisition Support
SP4703-07-D-0006	DSCR Acq Support (DPT)	$324,000	Acquisition Support
SP4703-08-C-0013	DSCR Acq Support (BSIT)	$623,607	Acquisition Support
46032822	DTRA IT (L-M)	$1,100,000	IT Services
W91QUZ-07-D-0029	US Army, DoD	$103,750	Acquisition Support
22322	Office of Dietary Supplements, NIH	$250,000	IT Services
GS-35F-0258J,132-51	Surface Distribution and Deployment Command, DoD	$955,543	IT Services
GS-06F-0173Z	St. Lawrence Seaway Commission, DOT	$12,405	IT Services

FISCAL YEAR 2008

Federal Grant(s)/Contracts	Federal Agency	Dollar Value	Subject(s) of Contract or Grant
HDTRA1-04-C-0009	Defense Threat Reduction Agency, DoD	$3,559,464	IT Services
GS-06F-0173Z	Surface Distribution and Deployment Command, DoD	$955,536	IT Services
GS-06F-0173Z	Office of Surface Mining, DOI	$803,484	IT Services
GS-35F-0258J,132-51	Bureau of Indian Affairs, DOI	$1,218,500	IT Services
GS-00F-0052M	USMC, DoD	$216,000	Logistics Services
DE-AT06-02-RL14443	NSPS	$144,000	
GS-00F-0052M	Defense Supply Center Philadelphia, DLA, DoD	$11,767,136	Acquisition Support
GS-00F-0052M	Defense Supply Center Columbus, DLA, DoD	$10,193,251	Acquisition Support
SP0103-04-D-0008	Defense Logistics Agency, DoD	$115,800	Analytical Support
NRC-10-06-401	Nuclear Regulatory Commission, DOE	$162,791	Administrative Support
HDTRA1-08-F-0007	Defense Threat Reduction Agency, DoD	$510,918	IT Services
PR&C NUMBER 80666428	US Army Corps of Engineers, DoD	$2,495	IT Services
SP0103-04-D-0008	Defense Logistics Agency, DoD	$270,000	Acquisition Support
DTFAWA-03-D-03018	Federal Aviation Administration, DOT	$176,458	Acquisition Support
SP4703-07-D-0006	Defense Supply Center Richmond, DLA, DoD	$312,734	Acquisition Support
SP4703-08-C-0013	Defense Supply Center Richmond, DLA, DoD	$427,429	Acquisition Support
QQC001642	Alcohol, Tobacco, and Firearms, DHS	$97,685	IT Services
M637854-02-A-9015	USMC, DoD	$9,335	Logistics Services
Sub AFPS-SC-001	US Army, DoD	$37,782	IT Services
46032822	Defense Threat Reduction Agency, DoD	$158,315	IT Services
W91QUZ-07-D-0029	US Army, DoD	$84,384	IT Services
HDTRAA-08-D-0007	Defense Threat Reduction Agency, DoD	$12,248	IT Services
22322	Office of Dietary Supplements, HHS	$120,000	IT Services

FISCAL YEAR 2007

Federal Grant(s)/Contracts	Federal Agency	Dollar Value	Subject(s) of Contract or Grant
HDTRA1-04-C-0009	Defense Threat Reduction Agency, DoD	$3,702,976	IT Services
GS-06F-0173Z	Surface Distribution and Deployment Command, DoD	$786,806	IT Services
GS-35F-0258J,132-51	Bureau of Indian Affairs	$1,518,746	IT Services
GS-00F-0052M	Defense Supply Center Philadelphia, DLA, DoD	$13,801,005	Acquisition Support
GS-00F-0052M	Defense Supply Center Columbus, DLA, DoD	$6,127,109	Acquisition Support
SP0103-04-D-0008	Defense Logistics Agency, DoD	$56,850	Analytical Support
GS-00F-0052M	USMC, DoD	$490,808	Logistics Services
NRC-10-06-401	Nuclear Regulatory Commission, DOE	$113,594	Administrative Support
HDTRA1-08-F-0007	Defense Threat Reduction Agency, DoD	$559,842	IT Services
HSBP1004F00450	Customs and Border Protection, DHS	$27,448	IT Services

GS-00F-0052M	US Secret Service, DHS	$98,083	Acquisition Support
GS-35F-0258J,132-51	Defense Supply Center Richmond, DLA, DoD	$57,498	Acquisition Support
SP4703-07-D-0006	Defense Supply Center Richmond, DLA, DoD	$110,471	Acquisition Support
QQC001642	Alcohol, Tobacco, and Firearms, DHS	$20,525	IT Services
GS-00F-0052M	USMC, DoD	$13,459	Logistics Services
Sub AFPS-SC-001	US Army, DoD	$3,792	IT Services
DTRA01-99-C-0107	Defense Threat Reduction Agency, DoD	$20,169	IT Services

Federal Contract Information: If you or the entity you represent before the Committee on Armed Services has contracts (including subcontracts) with the federal government, please provide the following information:

Number of contracts (including subcontracts) with the federal government:

Current fiscal year (2009): 18
Fiscal year 2008: 23
Fiscal year 2007: 17

Federal agencies with which federal contracts are held:

Current fiscal year (2009): DOD, DOI, DOT, HHS, DHS, DOE
Fiscal year 2008: DOD, DOI, DOT, HHS, DHS, DOE
Fiscal year 2007: DOD, DOI, DOT, HHS, DHS, DOE

List of subjects of federal contract(s) (for example, ship construction, aircraft parts manufacturing, software design, force structure consultant, architecture & engineering services, etc.):

Current fiscal year (2009): IT Services, Acquisition Support, Analytical Services, Administrative Services, Logistics Services
Fiscal year 2008: IT Services, Acquisition Support, Analytical Services, Administrative Services, Logistics Services
Fiscal year 2007: IT Services, Acquisition Support, Analytical Services, Administrative Services, Logistics Services

Aggregate dollar value of federal contracts held:

Current fiscal year (2009): $23.5M (est)
Fiscal year 2008: $29.6M
Fiscal year 2007: $28.5M

Federal Grant Information: If you or the entity you represent before the Committee on Armed Services has grants (including subgrants) with the federal government, please provide the following information:

Number of grants (including subgrants) with the federal government:

Current fiscal year (2009):	None
Fiscal year 2008:	None
Fiscal year 2007:	None

Federal agencies with which federal grants are held:

Current fiscal year (2009):	None
Fiscal year 2008:	None
Fiscal year 2007:	None

List of subjects of federal grants(s) (for example, materials research, sociological study, software design, etc.):

Current fiscal year (2009):	N/A
Fiscal year 2008:	N/A
Fiscal year 2007:	N/A

Aggregate dollar value of federal grants held:

Current fiscal year (2009):	N/A
Fiscal year 2008:	N/A
Fiscal year 2007:	N/A

Testimony of
David Madland, Ph.D.
Center for American Progress Action Fund

Before the Panel on Defense Acquisition Reform
House Committee on Armed Services

September 17, 2009

Chairman Andrews and Ranking Member Conaway, I am David Madland, Director of the American Worker Project at the Center for American Progress Action Fund.

I am pleased to appear before the Panel on Defense Acquisition Reform today and applaud your efforts to ensure that federal contracting provides taxpayers with good value for the money. As the work of this panel, as well as many others in Congress and the administration has made clear, the federal contracting process needs to be reformed to limit waste and better ensure the government's interests are upheld.

While the Center for American Progress and Center for American Progress Action Fund have advocated for a range of reforms including: increasing competition, strengthening the acquisition workforce, improving transparency and oversight, and preventing the contracting out of essential government functions, I want to focus on a less well-known but equally critical issue: the pay, benefits and working conditions of the low-wage contract workforce.[1]

As I will explain, the contracting process gives inadequate consideration as to how contractors treat their workforce, which can cause the Department of Defense to receive less than full value for its investments.

In my testimony, I want to make three main points:

First, many federally contracted workers have low-quality jobs. The workers I am talking about sew military uniforms, rebuild army bases, and provide security for secure facilities.

Second, while poor treatment of workers is an important problem in its own right, more to the point of this panel, low pay, limited benefits and poor working conditions impose costs on the government and taxpayers and make it hard for high-road companies to compete.

Third, promoting higher labor standards can be part of a strategy for ensuring better value in contracting.

I. Impact on workers

First, let me describe the scope of the problem of low-quality jobs in the federal contracting. I want to emphasize that the data are rough because the federal government neither keeps nor makes publicly available quality data. However, all the evidence points in the same direction of a widespread problem. Estimates from the Economic Policy Institute indicate that 20 percent of all federally contracted workers earn poverty-level wages and often do not receive benefits.[2]

That means that one in five workers on a federal contract do not earn enough to keep a family of four out of poverty.

And low wages are much more common in some contracted industries. Paul Light, a professor at the New York University's Wagner School of Public Service, estimates that 80 percent of service contract workers earn low wages, and often do not receive benefits.[3] A 2006 survey by the union UNITE HERE! found that many textile employees working on military contracts earned a starting wage of less than $5.50 an hour and an average wage of $6.55.[4] Between 50 and 80 percent of workers at factories survey had no employer-provided health insurance, and none had an employer-provided retirement plan.

Not only is the pay quite low for many federally contracted workers, but working conditions are often of low quality, with contracting companies commonly violating labor laws.

- According to a study by the U.S. Government Accountability Office, in 2004 the Department of Labor conducted 654 Service Contract Act investigations called by workers or other whistleblowers and found that in more than 80 percent of cases—comprising 20,347 individual violations—employers were indeed failing to pay their employees the minimum wages and benefits owed them under the law.[5]

- According to another government study, 80 companies that had committed unfair labor practices in violation of the National Labor Relations Act received more than $23 billion from more than 4,400 federal contracts, representing roughly 13 percent of all federal contract dollars in fiscal year 1993, the most recent year studied.[6]

- Companies with poor health and safety records also continue to receive federal contracts, according to GAO. In the most recent survey year, 1994, 261 federal contractors administered facilities that had been cited for 5,121 violations of the Occupational Safety and Health Administration's safety and health regulations. Those contractors received a total of $38 billion, representing 22 percent of all federal contract dollars. Eighty-eight percent of those worksites inspected were found to have one or more violations that posed a risk of death or serious physical harm to workers. In 69 percent of cases, OSHA found the employer to have intentionally and knowingly committed the violation.[7]

- The Center for American Progress Action Fund reviewed security contracts from four large federal agencies in 2006 that were awarded without competition—a total of $1.7 billion in contracts. We found that of the 12 security companies awarded these contracts, 10 had records of labor abuse. While a few labor violations were relatively minor, others were much more significant, ranging from repeated safety and health violations and violations of the Fair Labor Standards Act to discrimination, sexual harassment, nonpayment of wages, and human rights violations.[8]

- A report by the Brennan Center for Justice found pervasive violations of prevailing-wage laws in New York City and concluded that: "Unscrupulous employers understand that there is a minimal risk of being caught for these violations, and even if they are caught, that they will likely pay no more than a portion of the wages they owe."[9]

II. Taxpayer value

Second, these kinds of working conditions can cause taxpayers to receive less than full value in government contracts.

When workers are poorly compensated on the front end, taxpayers often bear additional costs on the back end, such as for Medicaid, Earned Income Tax Credit and food stamps.[10] In practice, this amounts to something like a government subsidy for low-road companies, while high-road companies are placed at a competitive disadvantage.

Furthermore, research finds that when contractors cut corners with their workers, they often cut corners in the final product they deliver to taxpayers.

As early as the 1980s, an audit by the U.S. Department of Housing and Urban Development found a "direct correlation between labor law violations and poor quality construction" on HUD projects, and that these quality defects contributed to excessive maintenance costs. HUD's Inspector General concluded that "[T]his systematic cheating costs the public treasury hundreds of millions of dollars, reducing workers' earnings, and driving the honest contractor out of business or underground."[11]

More recently, a survey of New York City construction contractors by New York's Fiscal Policy Institute found that contractors with workplace law violations were more than five times as likely to have a low performance rating than contractors with no workplace law violations.[12]

Of the top 50 contractors cited as the most wasteful by the Project on Government Oversight, 28 had reported labor violations ranging from religious, racial, and age discrimination, retaliation against worker complaints, workplace safety violations,

harassment, unfair termination, nonpayment of overtime, violations of the Americans with Disabilities Act, and radioactive contamination of workers.[13]

Research by the Center for American Progress Action Fund finds that there is a correlation between contractors' failure to adhere to basic labor standards and wasteful practices and sometimes even a correlation between this failure and illegal activity.[14] Similarly, according to the GAO, contracting companies have hired security guards for Army bases with criminal records. "At two separate installations," the GAO found, "a total of 89 guards were put to work even though they had records relating to criminal offenses, including cases that involved assault and other felonies."[15] And recent investigations of the U.S. Embassy in Kabul, Afghanistan found that contracted security guards suffered from "serious understaffing, bullying by management, petty corruption and abusive work conditions … [that] threatened the security of the compound."[16]

III. Promotion of higher labor standards

Third, promoting good workplace practices can be a good value for taxpayers. Not only can doing so reduce the government's unintentional "subsidies" for low-road companies, but it also can promote increased competition and reduce the likelihood that companies will operate in a wasteful fashion.

As a review of state and local contracting practices by the National Employment Law Project finds, "…better paid workforces typically enjoy decreased employee turnover (with corresponding savings in re-staffing costs), increased productivity, and improvements in the quality and reliability of the services that they provide."[17]

Perhaps even more importantly, promoting higher standards encourages high-road companies to bid on projects.

For example, after Maryland implemented a living wage standard, the average number of bids for contracts in the state increased nearly 30 percent—from 3.7 to 4.7 bidders per contract.[18] Nearly half of contracting companies interviewed by the state of Maryland said that the new labor standards encouraged them to bid on contracts because it leveled the playing field. Several companies commented that in the future they will only bid on living wage contracts because of the leveling effect it has on competition. One current contractor noted that her contract was the first state procurement for which her firm had submitted a bid. She explained that without strong labor standards, "the bids are a race to the bottom. That's not the relationship that we want to have with our employees. [The living wage] puts all bidders on the same footing."[19]

Other studies of local efforts to raise labor standards in contracting have found similar effects. A study of the Boston, Hartford and New Haven living wage laws found that "competitive bidding remains strong under living wage ordinances, and that such laws may even boost the number of bidders on city contracts."[20] And a review of the San

Francisco Public Utilities Commission responsible contracting "prequalification" system has increased the pool of highly experienced firms willing to bid for its work and created an environment in which firms of similar caliber compete against one other for agency contracts.[21]

Over the past decade, as the federal government's contracting problems have been mounting, state and local governments have been leading the way to promote higher standards for the treatment of contract workers, as an excellent report by the National Employment Law Project makes clear.[22] New York City has become a model of transparency with its public Vendex database containing important information about contracting companies, California is a leader for its rigorous pre-screening process, and the city of El Paso uses bid scoring to promote health care coverage among contracted workers. These and other governments have implemented the kinds of reforms that the federal government can and should replicate.

Recommendations

While there are many steps that Congress and the administration can and should take to improve the treatment of the contracted workforce and promote better value for taxpayers, I want to highlight two of the most important reforms.

First, to limit the number of contracts that are awarded to low-road companies, the federal contracting process should do a better job screening companies based on their overall regulatory record, including the company's compliance with labor laws.[23] To do so will require clarifying standards for evaluating whether bidders demonstrate "a satisfactory record of integrity and business ethics," and thus are responsible.[24] It will also require creating better tools to help contracting officers make this determination, such as improving the centralized contracting database that is being created to better capture labor law violations—many of which currently are not included because labor law violations are often below the database's monetary threshold and are often resolved without acknowledgment of fault.

Second, the contracting process should promote higher labor standards by evaluating proposals based in part on the quality of jobs that contractors provide their workers.[25] Many federal, state, and local government contracting processes already promote high standards by evaluating offers based on price as well as whether companies provide good jobs or meet other social objectives. The federal government can adopt the best features of these bid evaluation systems and weigh, for example, whether companies pay decent wages and provide good benefits.

These reforms would not only be the right thing to do for workers, but they would also improve accountability, increase transparency, limit wasteful contracting and help ensure value for taxpayers.

I want to thank the panel for its time and consideration and express my willingness to work with you as you seek to reform the contracting process.

Information about the American Worker Project: The American Worker Project conducts research to increase the wages, benefits, and security of American workers and promote their rights at work. It is a project of the Center for American Progress Action Fund, a progressive think-tank dedicated to improving the lives of Americans through ideas and action.

Endnotes

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[2] Kathryn Edwards and Kai Filion, "Outsourcing poverty: Federal contracting pushes down wages and benefits," (Washington: Economic Policy Institute, 2009).

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David Madland
Director of the American Worker Project

Dr. David Madland is the Director of the American Worker Project at American Progress. He has written academic articles, books, op-eds and commentaries on a range of economic issues, primarily focused on retirement, jobs, and public opinion. He has a Ph.D. in government from Georgetown University and received his B.S. from the University of California at Berkeley. David's dissertation about the political reaction to the decline of the defined benefit retirement system was awarded the Best Dissertation Award by the Labor and Employment Relations Association.

Prior to joining American Progress, David helped lead a range of advocacy campaigns as a consultant to labor unions and environmental organizations. Previously, he worked for Congressman George Miller (D-CA) on the House Committee on Education and the Workforce as well as the Resources Committee. He was political director of the environmental organization Save the Bay, policy director for the taxpayer watchdog Taxpayers for Common Sense, and research director for Michela Alioto for Congress.

http://www.americanprogressaction.org/aboutus/staff/MadlandDavid.html

DISCLOSURE FORM FOR WITNESSES
CONCERNING FEDERAL CONTRACT AND GRANT INFORMATION

INSTRUCTION TO WITNESSES: Rule 11, clause 2(g)(4), of the Rules of the U.S. House of Representatives for the 111th Congress requires nongovernmental witnesses appearing before House committees to include in their written statements a curriculum vitae and a disclosure of the amount and source of any federal contracts or grants (including subcontracts and subgrants) received during the current and two previous fiscal years either by the witness or by an entity represented by the witness. This form is intended to assist witnesses appearing before the House Armed Services Committee in complying with the House rule.

Witness name: **David Madland**

Capacity in which appearing: (check one)

___Individual

_X_Representative

If appearing in a representative capacity, name of the company, association or other entity being represented:____Center for American Progress Action Fund_____

FISCAL YEAR 2009

federal grant(s) / contracts	federal agency	dollar value	subject(s) of contract or grant
None			

FISCAL YEAR 2008

federal grant(s) / contracts	federal agency	dollar value	subject(s) of contract or grant
None			

FISCAL YEAR 2007

Federal grant(s) / contracts	federal agency	dollar value	subject(s) of contract or grant
None			

Federal Contract Information: If you or the entity you represent before the Committee on Armed Services has contracts (including subcontracts) with the federal government, please provide the following information:

Number of contracts (including subcontracts) with the federal government:

Current fiscal year (2009):_____0_____;
Fiscal year 2008:_____0_____;
Fiscal year 2007:_____0_____.

Federal agencies with which federal contracts are held:

Current fiscal year (2009):_____None_____;
Fiscal year 2008:_____None_____;
Fiscal year 2007:_____None_____.

List of subjects of federal contract(s) (for example, ship construction, aircraft parts manufacturing, software design, force structure consultant, architecture & engineering services, etc.):

Current fiscal year (2009):_____None_____;
Fiscal year 2008:_____None_____;
Fiscal year 2007:_____None_____.

Aggregate dollar value of federal contracts held:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

Federal Grant Information: If you or the entity you represent before the Committee on Armed Services has grants (including subgrants) with the federal government, please provide the following information:

Number of grants (including subgrants) with the federal government:

Current fiscal year (2009):_____0_____;
Fiscal year 2008:_____0_____;
Fiscal year 2007:_____0_____.

Federal agencies with which federal grants are held:

Current fiscal year (2009):_____ None _____;
Fiscal year 2008:_____ None _____;
Fiscal year 2007:_____ None _____.

List of subjects of federal grants(s) (for example, materials research, sociological study, software design, etc.):

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

Aggregate dollar value of federal grants held:

Current fiscal year (2009):_____;
Fiscal year 2008:_____;
Fiscal year 2007:_____.

DOCUMENTS SUBMITTED FOR THE RECORD

SEPTEMBER 17, 2009

KBR

KBR STATEMENT
HOUSE ARMED SERVICES COMMITTEE
PANEL ON ACQUISITION REFORM
SEPTEMBER 17, 2009

KBR is pleased to submit this statement to the House Armed Services Committee's Panel on Acquisition Reform. As the contractor responsible for implementing LOGCAP III and one of three awardee companies under LOGCAP IV, KBR delivers world-class engineering, logistics, and service support to U.S. and Coalition forces, diplomats, and civilians serving in the Middle East and Central Asia. Because of KBR's extensive experience as a key battlefield logistics support provider, the company is uniquely qualified to help the Panel understand some of the many acquisition-related challenges facing our military when it undertakes expeditionary, stability, or reconstruction operations in hostile overseas environments. It is KBR's hope that these lessons learned may benefit the Department of Defense's acquisition planning and processes going forward.

In hindsight, it is obvious that no level of military acquisition planning could have adequately anticipated the rapidly changing and perilous environment that developed in Iraq. In response to questions from the House Armed Services Committee in January 2007, General David Petraeus, current Commander of the U.S. Central Command, acknowledged:

> First, there were a number of assumptions and assessments that did not bear out. Prominent among them was the assumption that Iraqis would remain in their barracks and ministry facilities and resume their functions as soon as interim governmental structures were in place. That obviously did not transpire. The assessment of the Iraqi infrastructure did not capture how fragile and abysmally maintained it was (and this challenge, of course, was compounded by looting). Additionally, although most Iraqis did, in fact, greet us as liberators (and that was true even in most Sunni Arab areas), there was an underestimation of the degree of resistance that would develop as, inevitably, a Shi'a majority Government began to emerge and the Sunni Arabs, especially, the Saddamists, realized that the days of their dominating Iraq were over.

It was in this tenuous security environment that the services provided under LOGCAP III task orders evolved to meet increasing military operational demands and to support the expanding US military presence. While the original contract stated the various essential services for which KBR would be responsible, the specific requirements associated with the location, quantity and types of facilities to be supported varied greatly from those described in the contract. Moreover, the availability of supplies and services to support American military operations were in constant flux. Thus, KBR and other contractors frequently had to develop solutions to wartime logistical challenges on the ground and in real time to support over 200,000 service members at over 215 sites throughout the CENTCOM theater.

The significant ramp-up in military operations and associated logistics support created several contract-related challenges. The pace of paperwork and Federal Acquisition Regulations (FAR)-required record keeping often trailed the demand for services and made administrative oversight by the Government more complicated and challenging. One such challenge concerned the need to definitize literally dozens of task orders. KBR and the Army created an integrated process and completed this significant task by March 31, 2005. KBR and the Army then worked to ensure that all subsequent task orders were definitized within the timeframe specified in the contract. This process saved significant amounts of time and effort and ensured timely negotiation of task order pricing, while ensuring compliance with applicable procurement regulations. In a wartime environment, state-side administrative and documentation requirements frequently present significant challenges for contractors whose primary obligation is to provide services to the soldier in a timely fashion.

Another challenge was the lack of availability of enough qualified personnel, both contractor and on the government side, to complete the administrative requirements associated with such large scale contract performance. Even given KBR's prior experience under LOGCAP I and the Balkans Support Contract, it was difficult to recruit and retain enough qualified contract support personnel.

As mentioned in the report of the Commission on Army Acquisition and Program Management in Expeditionary Operations (October 31, 2007), this staffing challenge is a significant factor facing both the Government and industry. As the size and tempo of the work in Iraq continued to grow, KBR addressed this challenge by implementing formal training programs in theater, and, for certain disciplines, performing training before employees were deployed to theater.

An issue that significantly affected the cost of the work under LOGCAP III was the incremental manner in which funding for the contract was provided. Because of administrative requirements, KBR often worked at financial risk or tracked potential issues and reported in accordance with "Limitation of Funds" clauses under the contract (FAR Subpart 32.7; FAR 52.232.22). Funding restrictions limited KBR's ability to obtain potential quantity or long term discounts. Further, the attendant inability to purchase rather than lease equipment from month to month also resulted in increased costs in many areas. In general, some adjustment to the FAR and DFAR regulations in recognition of the unique challenges associated with contracting in an operational, wartime environment should be undertaken.

One of the operational realities in the field that frequently confronts contractors is multiple and at times competing priorities from the Government with respect to contract performance. The military commander on the ground may express an immediate need because of real time battlefield necessities. Both Army Sustainment Command and the Defense Contract Management Agency (DCMA) are responsible for overseeing the contract, and both give instructions about what is or is not required or permitted under the contract. The Defense Contract Audit Agency (DCAA) and other after the fact auditors later come in and provide their view. As a result, many contract expenditures and actions look different to the Soldier and his commander during the heat of battle, than they may appear months or years later to a state-side auditor. As the contractor, we face the challenge of meeting the very real needs of the army fighting the war, while also satisfying the important demands of contracting officers and Government auditors. If the Panel can help guide the Government to

speak with one voice in instructing its contractors in future wartime contingencies, this would be a significant improvement to the current expeditionary contracting system.

The nature of contingency contracting in a wartime environment is such that, regardless of the depth of the planning, inevitably changes in the field during contract execution will occur. The reactions of the enemy can never be fully anticipated. Both the Government and contractors must be prepared to adapt and implement changes rapidly. Frequently, contractors will be confronted with liability exposure, including bodily injury to employees or others, or property damage to third parties. In order to retain a robust contractor community and industrial base willing and able to perform services in such an environment, it is necessary to control such exposure. We recommend that the Panel review the protections that are afforded to contractors working in such an environment, including those relating to liability under host country laws, Status of Forces Agreements, the Defense Base Act, and other statutes that expose contractors to potential liability for work performed at the direction and control of the Government.

Finally, given the importance of advance planning to the efficient delivery of services (as well as the conduct of military operations), the Government should develop a way to allow contractors to play a formal consultative role during the military's own operational planning process. In saying this, KBR is very cognizant of the concerns that have been expressed regarding contractors assuming inherently governmental functions. However, while the actual planning must properly remain the job of the military, the companies who will bear the responsibility for providing the food, shelter, equipment, and other logistical support necessary for the successful execution of those plans would be able to do a better job and would be able to share their considerable knowledge of logistics support operations if they are incorporated more formally into the operational planning process than is currently the case. In this regard, the most recent *Quadrennial Defense Review* states:

> [I]mplementing the new Department of Defense Instruction, Contractor Personnel Authorized to Accompany U.S. Armed Forces, is another step toward integrating contractors into the Total Force. The Department's policy now directs that

> performance of commercial activities by contractors, including contingency contractors and any proposed contractor logistics support arrangements, shall be included in operational plans and orders. By factoring contractors into their planning, Combatant Commanders can better determine their mission needs.

Quadrennial Defense Review, February 6, 2006, p. 81. KBR recommends that this direction be consistently conducted and that its implementation include formal and routinized input from contractors and contracting commands with experience in performing and managing support services and construction in contingency operations environments.

KBR remains proud of the work it performs in Iraq and around the world. Our employees perform their jobs in austere, unpredictable conditions at great sacrifice to themselves and their families – all in order to help our military succeed in its mission. We remain committed to engaging in a transparent and fact-based dialogue while pledging continued full cooperation and support to our military and to our men and women in uniform.

WITNESS RESPONSES TO QUESTIONS ASKED DURING THE HEARING

SEPTEMBER 17, 2009

RESPONSE TO QUESTION SUBMITTED BY MR. ANDREWS

Mr. SYLVESTER. Of the 106 regular members of Aerospace Industries Association, 68 or 64% are publicly traded and 38 or 36% are privately held. [See page 16.]